



The Scottish Parliament
Pàrlamaid na h-Alba

FINANCE COMMITTEE

AGENDA

3rd Meeting, 2012 (Session 4)

Wednesday 25 January 2012

The Committee will meet at 10.00 am in Committee Room 6.

1. **Decision on taking business in private:** The Committee will decide whether to take item 4 in private.
2. **Public Sector Pay:** The Committee will take evidence from—

Will Hutton, Principal, Hertford College, University of Oxford and author of the Review of fair pay in the public sector.
3. **Fiscal Sustainability: universal services:** The Committee will take evidence from—

Robert Black, Auditor General for Scotland;

Paul Brewer, Partner, Corporate Finance, Infrastructure and Government, Pricewaterhouse Coopers;

Graeme Downie, Communications Manager, National Endowment for Science Technology and the Arts;

Professor Jim Gallagher, School of Law, University of Glasgow;

Professor Jeremy Peat, David Hume Institute;

Dr Andrew Walker, Institute of Health and Wellbeing, University of Glasgow.
4. **Long Leases (Scotland) Bill:** The Committee will consider its approach to the Financial Memorandum of the Long Leases (Scotland) Bill.

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The papers for this meeting are as follows—

Agenda item 2

Paper by the Clerk

FI/S4/12/3/1

Agenda item 3

Paper by the Clerk

FI/S4/12/3/2

Agenda item 4

PRIVATE PAPER

FI/S4/12/3/3 (P)

Finance Committee

3rd Meeting, 2012 (Session 4), Wednesday, 25 January 2012

Public sector pay

Purpose

1. The purpose of this paper is to provide background information for the evidence session with Will Hutton. Mr Hutton will discuss issues and findings from his [Review of fair pay in the public sector](#). A copy of the Review's foreword, executive summary and summary of full recommendations is attached at Annex A.
2. The paper also draws to the Committee's attention consideration given to the issue of pay e.g. during the recent draft budget scrutiny.

Background

Hutton Review

3. Mr Hutton was commissioned by the Prime Minister and Chancellor of the Exchequer in June 2010 to 'make recommendations on promoting pay fairness in the public sector by tackling disparities between the lowest and the highest paid in public sector organisations'.
4. His [report](#) was published in March 2011. No response to it from the UK Government has yet been published.
5. The Review stated that—

'The UK therefore needs a framework for fairness in senior public service pay. This framework should be based on the principle of fairness as due desert: reward should be proportional to the weight of each role and each individual's performance; should be set according to a fair process; and should recognise that organisations' success derives from the collective efforts of the whole workforce. This fairness framework will ensure that senior pay in public services is fair and seen to be fair, and will preserve the ability of public services to recruit talented individuals while reassuring the public that their tax money is not being unfairly creamed off by 'fat cat' public sector executives.'
6. It set out 12 recommendations (Annex A) on a range of issues including the adoption of a fair pay code, enabling citizens analysis of executive pay and that senior public servants' pay should be directly linked to their performance and be explained transparently to the public.
7. While the UK Government has not yet published its response, the Committee, in [its draft budget report](#), invited the Scottish Government to set out its views. It provided two responses, one within its overall response to the Committee's budget report and then a follow up response giving additional comment. Both are attached as Annex B.

Draft Budget scrutiny

8. Alongside the Scottish Spending Review and Draft Budget 2012-13 the Scottish Government published [Public Sector Pay Policy for Staff Remits 2012-13](#). This sets out its pay policy in relation to a number of public bodies within its responsibility (listed in Annex A to the Policy) and has three strategic aims, to—

- make sure that public sector pay settlements are tightly constrained in the current financial climate; remain affordable and sustainable; and, through the targeting of resources, that value for money is secured;
- provide flexibility within an overarching policy of pay restraint for public bodies to provide some support for the lower paid; and
- continue to work towards making sure that pay is fair and non-discriminatory.

9. A pay freeze for all staff will apply for 2012-13. In addition, payments linked to performance or paid to staff on their maximum, are also suspended for 2012-13.

10. Employers covered by the policy are required to apply a Scottish Living Wage. The policy makes a commitment that all staff earning less than £21,000 per annum should receive a minimum annual pay increase of £250.

11. The Scottish Government states that a key element of its pay policy over the last four years has been the commitment to no compulsory redundancies. It will continue this commitment for a further year on condition that agreements are reached on flexible working practices which reduce costs while maintaining headcount and services.

12. In addition to inviting the Scottish Government to set out its views on the Hutton review (see above), the Committee in [its draft budget report](#) (paragraphs 33-35) also sought clarification from the Scottish Government on whether the 'modest increases' in public sector pay has been accounted for in its spending plans during the spending review years. Further, the Committee highlighted the point made by the Economy, Energy and Tourism Committee in [its draft budget report \(paragraph 49\)](#) about the bonus culture within some parts of the senior civil service and some government agencies. The response from the Scottish Government is at Annex B, the extract from the EET Committee report is at Annex C.

13. Pay itself accounts for around 60% of the Scottish Government's resource expenditure. In his [Report on the Draft Scottish Budget 2012-13](#) Professor David Bell, the Committee's budget adviser, drew attention to the pay differentials between public and private sector workers. The extract from that report is attached as Annex D.

National Performance Framework

14. The National Outcomes within the Scottish Government's NPF describe what it wants to achieve and articulate its [Purpose](#). They 'help to sharpen the focus of government, enable our priorities to be clearly understood and provide a clear structure for delivery'. The outcome below may be relevant to the Committee wider consideration of pay in the public sector—

- Our [public services](#) are high quality, continually improving, efficient and responsive to local people's needs

15. Part of the Scottish Government's role in delivering on this outcome is to invest 'in people who deliver services through enhanced workforce development and effective leadership' and create 'a more transparent public service culture which improves standards of performance'. The outcome is underpinned by a number of National Indicators with the following perhaps being most relevant to this issue—

- [Improve people's perceptions of the quality of public services](#)
- [Improve the responsiveness of public services](#)

Independent Budget Review

16. The Independent Budget Review considered remuneration and workforce in its [report \(chapter 4\)](#). The panel made a specific suggestion in relation to the Hutton Review when it suggested that the Scottish Government (paragraph 4.61) 'provides evidence to the Review urging that particular attention is paid to the NHS Distinction Awards scheme, the cost of which appears significantly out of line with all other public sector non-consolidated performance pay/bonus arrangements, and further considers the position once the Fair Pay Review is completed'.

17. For information, a copy of the IBR's conclusions on remuneration and workforce is attached at Annex E.

Previous consideration

18. The previous Finance Committee undertook an [inquiry into public sector pay and published its report in 2009](#). That inquiry considered the—

- current public sector pay policy and the extent to which the aims of the policy have been achieved;
- processes for approving pay remits and the pay unit itself;
- negotiating machinery across the public sector; and
- pay policy for senior employees, with a particular focus on bonus arrangements.

19. In response to that Committee's report, the Scottish Government stated—

'The Scottish Government encourages public bodies to satisfy themselves that their pay systems do not discriminate on grounds of age and can be defended against challenge on such grounds. One of the strategic aims of the Public Sector Pay Policy is that bodies covered by the policy work towards ensuring that pay is fair and non-discriminatory. Specifically, one of the 2009-10 key pay policy priorities is for public bodies to reduce the widths of their pay ranges, where possible, and thus to work towards shorter progression journey times and sustainable progression costs.'

20. A copy of that inquiry's conclusions and recommendations is attached for information at Annex F

Public sector employment statistics

21. The Scottish Government has published (December 2011) [Public Sector Employment in Scotland: Statistics for 3rd Quarter 2011](#). This shows—

- In Q3 2011 there were 588,900 people employed in the public sector in Scotland, a decrease of 23,500 (3.8%) since Q3 2010. There were 2,486,000 people in employment in Scotland in Q3 2011 (increase of 0.3% from 2,479,000 in Q3 2010). In Q3 2011 public sector employment accounted for 23.7% of total employment, down from 24.7% in Q3 2010 and from 23.8% in Q3 1999. (In 1999 the banking sector was not included in the public sector).
- Of the 588,900 figure, 492,100 (83.6%) is accounted for by devolved public bodies and 96,900 (16.4%) to reserved public sector employment. Total employment in the devolved public sector has decreased from 513,300 in Q3 2010 to 492,100 in Q3 2011, a decrease of 21,200 (4.1%) over the year. This has been driven by a decrease in local government employment. Total local government employment decreased by 13,300 (4.5%) over the year to Q3 2011.
- Employment in the reserved public sector (with a presence in Scotland) has decreased by 2,300 (2.3%), since Q3 2010. Reserved public sector financial institutions increased by 100 (0.4%) in the last year and the reserved civil service decreased by 700 (2.1%).
- If banks were not included in the series, total public sector employment would have decreased by more, 23,600 (4.1%) instead of 23,500 (3.8%) over the year. Employment in the reserved public sector would have decreased by 2,400 (3.7%) instead of by 2,300 (2.3%) over the year. Financial institutions are not included in the devolved public sector total.

Pay responsibilities

22. Responsibility for pay sits with different bodies. A broad breakdown is provided at Annex G.

Conclusion

23. The Committee is invited to consider the issues highlighted in this paper.

Fergus D. Cochrane
Senior Assistant Clerk to the Committee

Foreword

Civilisation needs government to prosper, and so does the economy and society. There are urgent and widespread concerns about the current size of government, the need for reform to produce more adaptability and creativity and in particular the scale of the current budget deficit. I share those concerns. But equally it is impossible to see how the physical, social and human capital necessary to support economic recovery and growth, along with the redistribution of income needed to alleviate poverty, and measures to promote more equal opportunity are possible without government. Government and the public sector are too easily regarded as an obstacle to growth and the good society. Properly organised, led and managed they are instead their handmaiden. Indeed most public servants are animated by precisely this aim.

This is a more complex and nuanced view of the public sector than the usual dialogue of the deaf between those who think it unambiguously good or bad – with a no less binary view of the private sector. Interestingly this nuanced view is one that most private sector CEOs share. In the most recent annual global survey of CEOs conducted by PwC, a majority (61 per cent) certainly expressed concern over the size of fiscal deficits but simultaneously even more (72 per cent) supported government policies aimed at promoting growth that is economically, socially and environmentally sustainable. Business acknowledges it looks to governments to develop infrastructure, ensure stable capital markets, protect intellectual property, build a skilled workforce, deal with climate change, address inequality and reduce poverty – and of course to do all this with as little taxation and regulation as possible. Business leaders recognise the reality that economic growth is co-produced by a collaborative relationship with government, both discharging their proper responsibilities.

But while business recognises the role of government, it also looks to the public sector to transform itself. The public sector will need to lower its cost base and manage risk better, invest in talent and develop new innovative organisational forms in which to deliver public services more adaptively and responsively to citizen needs – all while preserving the crucial public character of accountability and universality of access. New service delivery models will need to emerge – standardising, streamlining and sharing inputs where possible – along with seeking innovative means of financing. This is not just a British problem: it confronts public sectors across the industrialised west.

Nor is the issue solely economic. Public institutions at their best are means of expressing collective will and social solidarity: we want a strong police force or to witness “meals on wheels” delivered to the elderly. The public realm, whether a beautiful public park or an effective health service, is essential to our well-being.

This is a substantive challenge – and pulling it off is crucial to securing a more balanced, innovative and high growth British economy. Success would be a fundamental building block in supporting economic growth and social well-being, but it cannot be done without motivated, high calibre public servants, along with managers to lead them. But while the British public is very sympathetic to front line delivery staff, it is hostile to the public sector managers responsible and accountable for the effective deployment of resources – and even more hostile to their pay. In the eyes of some, they are the quintessential “burdens” on the rest of us.

Part of the reason for this is that public sector managers have been caught up in the backlash to the remarkable growth of the earnings of the top 1 per cent over the last thirty or forty years and in particular in the last ten. Bank bail-outs with scarcely checked bonuses have dramatised these concerns. What has made the impact so toxic is the growing scepticism about whether the rise of pay at the top is the due desert of those who receive it. The public is partly right. Some of the rise in executive pay in the private sector at the top has been accompanied by little tangible improved performance. The public sector has not been immune from the same suspicion even though, as

detailed in the Interim Report, only one pound of every hundred pounds earned by the top one per cent of earners is earned by public sector employees. The perception is that the public sector is no less awash with 'fat cats'; indeed in one poll a quarter of respondents thought that public sector executives earned more than their private sector counterparts.

Against this backdrop the response is that the pay and the reward package of public sector executives has necessarily got out of hand, an accusation made harder to rebut because of the lack of a robust framework to justify top public sector pay. On a gut level, the reaction is understandable – but dangerous. If the national conversation takes it as a given that the public sector is necessarily a burden and a problem, it can only demotivate public sector staff. Meanwhile, attacking pay and the overall reward package, especially given the growing and extraordinary differentials with parts of the private sector, will make it harder to recruit and retain good people just at the moment the UK is embarking on an ambitious programme of public service reform – and the painful rebalancing of its economy.

Of course, there are problems: some public sector executive pay has been rising for reasons no less opaque than in the private sector with little attendant rationale. There are anomalies and, before the current pay freeze, signs that in the more autonomous parts of the public sector the arms race effects in CEO private sector pay were being reproduced – albeit less markedly. And of course, at the taxpayer's expense. The public has the right to know that pay is deserved, fair, under control and designed to drive improving public sector performance – and that there are no rewards for failure.

Something has to change, hence the impulse behind commissioning this Review, with its explicit assumption that a better definition of fair pay is the precondition to cooling this increasingly febrile atmosphere. But if asked to lead a review into fair pay, the author must have an idea of fairness that can consistently guide his or her thinking. The golden thread that runs through this review is the notion of fairness as due desert – workers at every level in any organisation should be rewarded in proportion to the real value of their contributions, but not rewarded either for good luck which they have done nothing to deserve, nor for free riding on the efforts of others. Their pay should be their due desert – no more and no less.

I therefore propose a new settlement with public sector leaders based on the principle of pay as due desert. The package of recommendations must be taken as a whole, but if implemented together should reassure the public that it is not being taken for a ride, while creating a pay and performance framework that over time should drive more innovative and creative behaviour. This framework will offer flexibility and fairness both to senior executives and the tax-paying public. There should be the flexibility to respond to market conditions in particular parts of the public sector without having to refer to Ministers, but equally senior executives need the protection of a fair pay framework to give them a robust defence when and if they come unjustifiably under attack.

I was asked to consider whether a public sector pay multiple, in which no manager could earn more than twenty times the lowest paid person in the organisation, would be helpful as the core of a fair pay system in the public sector and tackle pay disparities. I have concluded that it is not. The evidence is that a hard cap would be inoperable across a diverse public sector workforce. People at the top of very large and complex organisations, but with low paid workers, could earn less than people running simpler bodies but whose bottom workers were better paid.

Hard caps go against the spirit of fairness as due desert. Rather the task is to create a context in which pay is consistently judged against individuals' proportional contribution. I thus propose that every public body should annually publish the multiple of top to median pay in a clear and presentable way, and that the results should be published every year by the Senior Salary Review Body in a Fair Pay Report. Median earnings are a more representative measure of the pay of the whole workforce. Public sector executives and their remuneration committees are highly conscious of public scrutiny, and they will increase pay when the case is close to indisputable. But in case this not

enough I propose a system of enforcement which escalates from public admonition to direct intervention if pay rises in an unjustified fashion.

My second proposition is that a proportion of executives' base pay should be earned back subject to meeting performance objectives; where they are not met, that money will be lost. However, where managers surpass objectives, they will be eligible for additional pay. This will create a pay framework that, unlike parts of the private sector where executives only have degrees of upside and no downside to their pay, guarantees that executives have skin in the game. Most public servants do good, day-to-day work, but if they do not, this system will send a powerful message to the public that there are meaningful consequences for underperformance.

All this demands much stronger governance of the pay-setting process and independent assessments of performance indicators – at present very patchy. Organisations are social in character, and among the best equipped people to judge what constitutes good performance are the workforce. I recommend that employees should be represented on remuneration committees to help assess performance metrics – not only a means to ensuring that committees are more effective but to show that everybody is in the same organisational boat.

The public sector needs to make itself as attractive as possible to new recruits – and to deepen its talent pool. I propose that executive development and career paths within the public sector are radically opened up. There should be a single online portal for advertising management roles, an induction and entry training should be organised, and a passport scheme for middle and senior managers to allow them to work across the public sector and potentially private sector – deepening their opportunities and experience.

These measures are all brought together in my proposed Fair Pay Code which should not only be observed in the public sector – but by its major suppliers. This may be a demanding requirement for some PLCs whose business is largely in the public services industry – but it will be an important reminder that what they are doing, while privately run, remains in the public domain. Publicness matters, as does fair pay. It will also allow the government to protect itself from charges that it is turning over large parts of the public sector to profiteering private companies.

These fairness principles should also apply in the wider private sector. I recommend that the Government uses the provision in the coalition agreement to improve corporate reporting so that Britain follows the US and makes it a requirement that all quoted companies publish, monitor and explain their pay multiples. But the private sector has a larger problem to which it should pay heed. In many listed companies, too much remuneration is given in too undemanding a way, and the principle of earn back – in which executives face some downside risk – is often absent. In terms of creating social norms I very much hope that institutional shareholders and their industry associations will take up some of the fair pay principles and introduce them in the private sector. Britain could yet become a fairer and more productive society.

I have led this Review, but it would have been impossible without the excellent Treasury team who supported me. I would like especially to thank Kumar Iyer, Matt Ray, Iain Rolfe, Philippe Schneider, Balraj Sura and Benedict Wagner-Rundell, and to all those who have contributed their time and insights to the Review (whose names are listed in Annex G). It has been a privilege to work with them – and to apply some of my ideas on fairness to the real world of public and private sector pay.



Will Hutton

Executive summary

High quality public services require high calibre leaders to deliver them, especially in difficult fiscal conditions. A key challenge for Government is to maintain and improve the standard of public service leadership as the structures of public service delivery are reformed. Vital to this will be to ensure that public service leaders are adequately and fairly rewarded for their contributions, and that the public service ethos – that sense of mission and public duty that motivates many to work delivering public services – is maintained. This requires that a delicate balance be struck. If senior public servants are inadequately rewarded, it will be ever more difficult to attract and retain individuals of the calibre required. At the same time taxpayers are right to demand value for money from public resources, and an assurance that their money is not being wasted on excessive executive salaries. Without that assurance, trust in public services cannot be maintained.

Yet public understanding of both senior public service roles, and senior public service pay, is often very poor. A quarter of the public believe that public sector executives are currently paid more than their counterparts in private businesses, while in fact executive pay in large listed companies far outstrips that in even the largest and most complex of public bodies. The public also often have limited knowledge of what senior public servants actually do, so are not in a position to judge what level of reward is fair for these roles. Meanwhile the absence of a consistent framework of senior pay principles denies citizens reassurance that rewards are fairly matched to responsibilities and performance, and leaves a gap in which mistrust of public servants can grow.

The UK therefore needs a framework for fairness in senior public service pay. This framework should be based on the principle of fairness as **due desert**: reward should be proportional to the weight of each role and each individual's performance; should be set according to a fair process; and should recognise that organisations' success derives from the collective efforts of the whole workforce. This fairness framework will ensure that senior pay in public services is fair and seen to be fair, and will preserve the ability of public services to recruit talented individuals while reassuring the public that their tax money is not being unfairly creamed off by 'fat cat' public sector executives. This report presents the Fair Pay Review's conclusions, and sets out twelve recommendations to the Government that together form the framework for fairness.

The framework for fairness in senior public service pay: summary of recommendations

1 Using pay multiples to track executive pay against that of all employees

The Government should not cap pay across public services, but should require that from 2011-12 all public service organisations publish their top to median pay multiples each year to allow the public to hold them to account.

2 Informing the public debate through annual Fair Pay Reports

To support citizen accountability, the Government should commission the Senior Salaries Review Body to publish annual Fair Pay Reports, starting from 2011-12. These reports should set out trends in pay multiples across public services, highlight year-on-year changes and identify organisations that fail to produce meaningful, specific and verifiable explanations for their pay multiples and for changes.

3 Re-calibrating the pay of Non-Departmental Public Body chief executives

To address particular concerns that the pay of Non-Departmental Public Body chief executives has become detached from the responsibilities of their roles, the Government should by December 2011 establish a series of pay benchmarks for NDPB chief executives, following advice from the Senior Salaries Review Body.

4 From disclosure to explanation: ensuring complete transparency over executive roles and remuneration

To enable citizens to understand executive remuneration and the nature of executive responsibilities, from 2011-12 the Government should require that all organisations delivering public services disclose in precise numbers the full remuneration of all executives, alongside an explanation of the responsibilities of each role and of how executives' pay reflects individual performance.

5 Enabling citizen analysis of executive pay

From 2011-12, the Government should require public organisations to submit executive pay data through an online template, and make this data available on data.gov.uk, to allow citizens to access and analyse this data and thus have the information required to hold public service organisations to account.

6 Abandoning arbitrary benchmarks for public service pay

Once this framework of recommendations is in place, the Government should refrain from using the pay of the Prime Minister or other politicians as a benchmark for the remuneration of senior public servants, whose pay should reflect their due desert and be proportional to the weight of their roles and their performance.

7 Preventing rewards for failure through earn-back pay for senior public servants

To allow pay to vary down as well as up with performance, all public service executives should have an element of their basic pay that needs to be earned back each year through meeting pre-agreed objectives.

The Government should by July 2011 bring forward proposals for Senior Civil Service pay to include an element of base pay at risk, and should encourage the application of earn-back pay to other organisations delivering public services. This earn-back should be conditional upon meeting pre-agreed objectives; excellent performers who go beyond their objectives should be eligible for additional pay.

8 **Extending earn-back pay to high performing middle managers**

To identify and reward high fliers, once earn-back pay has been implemented at the most senior levels, Government departments and other public service organisations should consider offering this pay structure to middle managers on an opt-in basis.

9 **Sharing the rewards of greater productivity**

To prevent executives monopolising the rewards of productivity increases, and allow all employees who have contributed to share the benefits, government departments should identify ways of offering gainsharing schemes linked to achievement of the efficiency aspects of their business plans. The Government should also explore options for gainsharing schemes across public services more widely.

10 **Opening up opportunities for future generations of public service leaders**

To increase the supply of candidates for top positions and reinforce public service management as a career, the Government should facilitate greater opportunities for managers to move across different public services. By the end of 2011 the Government should establish a single online portal for advertisements and applications for public service management roles, and work with major public service employers to establish a passport scheme for middle and senior managers across public services. It should also drive and prioritise ongoing collaboration between public sector graduate recruitment and development programmes.

11 **A Fair Pay Code**

To embed fairness principles and ensure fair process in executive remuneration, all public service organisations should adopt the Fair Pay Code proposed by this Review. Government departments should by July 2011 bring forward proposals for the application of this Code to all bodies and sectors in which they have an interest.

12 **Tracking pay multiples across the economy**

To make tracking pay multiples normal practice across the economy, as part of its commitment to improve corporate reporting, the Government should require listed companies to publish top to median pay multiples in their annual reporting from January 2012.

The full text of the Fair Pay Review's recommendations is set out at Annex A. The full text of the proposed Fair Pay Code is set out at Annex B.

The case for fair pay in a reformed public sector

Fair pay should be understood as pay that reflects due desert: **fair pay must be both proportional to each individual's contribution and set according to a fair process.** Fairness is more than simple equality, individuals should face the consequences of their choices and efforts, but not be rewarded or punished for brute luck or circumstances beyond their control.

Fair pay is essential to high quality, well managed public services. Public services are vital co-creators of wealth and well-being, and have direct and important consequences for the lives of citizens. Public trust in public services requires that public service pay is fair and seen to be fair, and that public services stand up to high standards of scrutiny.

There are genuine concerns about executive pay in public services, as discussed in the Fair Pay Review Interim Report. These include top pay pulling away from bottom pay in many areas; a patchwork

quilt of governance arrangements; inadequate transparency; insufficient competition in executive labour markets; and the risk of senior pay inflation where institutions are granted autonomy over pay. **Taxpayers are right to demand value for money from public resources, and assurance that their money is not being wasted on excessive executive salaries.**

Yet the public overestimates how much public sector executives are paid. The sharp increase in executive pay over the last decade, and the wider trend of growing income inequality, has been largely a private sector phenomenon.

The UK must take care to avoid making the public sector a fundamentally unattractive place for those with talent and drive. Management roles in public services are becoming more complex and risky, making the need for talent greater than ever. Meanwhile elements of the wider public sector reward package are being cut back. If the wider value of public service is diminished, the talented and motivated will only be willing to work in public services to the extent that they are paid what they can make elsewhere.

A delicate balance must be struck between defending the attractiveness of public service careers while ensuring taxpayers can be confident that public money is being wisely used. **A framework for senior pay is required that is understood by both citizens and public servants to be fair, and to guarantee that public servants' pay is duly deserved for contributions that citizens value.**

Pay multiples, transparency and public accountability

The Fair Pay Review was asked to consider the case for a fixed limit on pay dispersion in the public sector, and a ban on managers earning more than 20 times the pay of the lowest paid person in their organisation. **A single limit on pay dispersion would however be unfair, hitting some organisations more than others,** and could create perverse incentives and even become a target for executives earning less. At present, a 20 to 1 maximum multiple would impact as few as 70 senior managers.

Rather than complying with a cap, organisations delivering public services should track, publish and explain their pay multiples over time. The most appropriate metric for pay dispersion is the multiple of chief executive to median earnings. This will ensure public service organisations are accountable for the relationship between the pay of their executives and the wider workforce.

To aid citizen scrutiny of organisations' pay multiples, **the Government should commission the Senior Salaries Review Body to publish annual Fair Pay Reports,** setting out pay multiples across public services, highlighting year-on-year changes and identifying organisations that fail to produce specific and verifiable explanations for their multiples and for any changes. If in the light of these reports the Government judges that pay multiples have increased without adequate justification, it should consider intervening directly to restrict executive pay.

Given the inconsistencies in their executive pay, **the Government should establish a system of benchmarks for executive pay in Non-Departmental Public Bodies on the advice of the Senior Salaries Review Body** in parallel with requiring them to public pay multiples year on year.

To ensure complete transparency over executive pay, and to aid greater public understanding of senior roles and their remuneration, **all organisations delivering public services should disclose full details of executive remuneration, together with an explanation of how executive pay relates to the weight of roles and individuals' performance.** The Government should establish an online system for comprehensive disclosure of pay data in a consistent, re-usable format to allow citizens and third-party organisations to collate and analyse these data.

Greater transparency, disclosure and explanation will allow a more rational and informed debate on senior public service pay, and enable citizens to hold public service organisations to account. **This will remove the need for simplistic benchmarks, such as the pay of the Prime Minister.**

Ensuring pay reflects performance

Understanding fairness in terms of due desert inevitably implies that pay should vary according to individuals' performance. Despite well-rehearsed objections to performance pay in the public sector, there are compelling reasons why performance pay for senior staff should not be abandoned in the face of public criticism of bonuses, or because of difficulties of implementation. An outright rejection of performance pay implies that there should be no financial reward to differentiate the good from the poor performer.

The public demands consequences for failure as well as rewards for success, and behavioural studies suggest that individuals are more powerfully influenced by the prospect of losses than of gains. There therefore needs to be a better balance between rewards and penalties in performance pay schemes. The Government should give serious consideration to reconfiguring performance pay systems for senior managers to include an element of 'earn-back' pay. This system would see executives required to meet pre-agreed performance objectives in order to earn back an element of their basic pay that had been placed at risk. Only if objectives were met would executives receive their full basic pay, and only if objectives are clearly exceeded can additional awards be made.

The public sector may be missing out on high calibre individuals because it does not offer sufficient opportunities and incentives to perform. Public sector organisations may not do a satisfactory job of spotting and developing future senior managers at the mid-career stage. If employees were not eligible for additional performance pay unless they also signed up to earn-back, this could prove a useful way of helping to attract and identify strong performers.

It should be possible to design team-based incentives that reconcile the importance of due desert with the reality that outcomes are collectively produced by the whole of an organisation's workforce. In this context, gainsharing – the sharing of the rewards from productivity gains and resultant savings among all the staff that contributed to them – is an option that should feature more often.

Strengthening the talent pipeline

The ability to attract, retain and develop high calibre employees is a vital prerequisite of strong and innovative public services. Action is needed to support and expand the 'pipeline' of talent that supplies public service organisations.

There are four key priorities in this area. The talent pool from which executives are recruited should be broadened, to minimise the risk of constrained supply putting upward pressure on senior pay. Managers should be supported at all stages of their development, to maximise the opportunities for managers to progress and build varied careers within public service. Broader career paths should be encouraged to produce the cross-sectoral skills vital for public service reform to succeed. And the profile of public service leadership should be raised to reinforce the value and ethos of public service and help the public sector to compete for the best.

A cultural shift is needed among recruiters, who should be encouraged to be more open to talent across public services, and given the infrastructure to allow them to look more widely when filling top positions. An online recruitment portal for the advertisement of management roles across public services would help achieve this. There would also be benefit in a 'passport' scheme that helped open up movement across different areas of public services, as well as to and from the private sector. This would not just help ensure adequate competition for top jobs to restrain unnecessary pay inflation, but would also help to match public servants' desire for greater opportunity and progression with the need to develop people capable of leading public services in a time of institutional reform and disaggregation.

Attention also needs to be given to the leaders of the future. Given the influence of factors such as career prospects and job security on attracting graduate recruits, there are risks to the quality of the

public service workforce if these factors are diminished, especially in a time of spending restraint. **Greater collaboration between graduate schemes can help ensure graduates see a career in public services as having varied career prospects. It should also help graduate recruits to develop the cross-sectoral experience and genuine generalist skills that leaders of the future will need.**

A Fair Pay Code

Independent pay-determination is vital for fairness, particularly where pay can vary with performance. Employees must perceive that pay-setting processes are fair, and be assured this they are free from arbitrary influences such as political interference. Taxpayers must also be confident that decisions about pay and performance are robust and protected against undue managerial influence.

Pay governance practices currently vary significantly across public services. Such variation is not necessarily a problem, but to reassure the public **a consistent framework of pay principles should be established.**

The Senior Salaries Review Body has produced a draft Code of Practice on senior pay. This has much to recommend it, but does not include fairness among its principles. Building upon this work, **this Review has therefore produced a Fair Pay Code, to be adopted by all organisations delivering public services on a 'comply or explain' basis.**

This new Code includes provisions on proportionality in executive pay, the use of variable pay and enhanced disclosure of executive pay in line with the recommendations of this Report. It also requires improved independent pay-determination processes.

To ensure that decisions on executive pay take account of the whole workforce context, and that executive pay decisions are justifiable to all employees, **organisations delivering public services should include an employee representative in the membership of their remuneration committees.**

There are risks in a 'comply or explain' approach; hence the importance of supporting good governance with the potential for tougher regulatory intervention, through a 'pyramid' of gradually escalating sanctions.

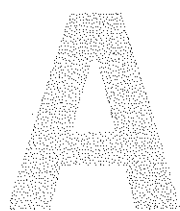
Fair Pay as a Social Norm

The principle set out in this Review, that pay should reflect due desert, set within a fair process, applies more widely than just to the issue of differentials between top pay and the pay of the rest. It is unfair that anyone should be rewarded or penalised for the brute luck of having been born male or female, or into any given ethnic or socio-economic background.

The revolution in executive remuneration is part of a wider trend of increasing pay dispersion. Some of this will have been fair and deserved, but some attributable to brute luck and economic rent. There is growing concern that increasing executive pay is not justified, and that it has detrimental results for organisations and for society at large.

The pay norms that are accepted where public meets private will affect the ability of public sector organisations to recruit and retain. Hence it is **important that the Fair Pay Code and as far as possible the other recommendations of this Review are extended into the public services industry.**

The framework of tracking multiples, of transparency and explanation, of earn-back, of escalating intervention, and of widening the talent pool, should be applied in the private sector.



Summary of full recommendations

RECOMMENDATION 1: Using pay multiples to track executive pay against that of all employees

The Government should not cap pay across public services, but should require that from 2011-12 all public service organisations publish their top to median pay multiples each year to allow the public to hold them to account.

The Government should require that public bodies annually publish chief executive's (or equivalent) earnings, median earnings of the organisation's workforce, and the ratio between these two figures in their annual remuneration reports. All taxable earnings should be included within this multiple. Year-on-year movements in the chief executive's earnings and median earnings should be disclosed and explained. Disclosures should begin in remuneration reports covering the financial year 2011-12, including prior year comparators.

To this end, the Government, with advice from the Financial Reporting Advisory Board, should at the earliest opportunity amend the disclosure requirements in the Financial Reporting Manual (FRM) to require organisations to include the disclosures above, and should work with relevant bodies to make similar amendments to other relevant guidance including the NHS Manuals, the NHSFT FRM the IFRS based Code of Practice on Local Authority Accounting, and guidance for remuneration reports by NDPBs not covered by the FRM.

The Government should encourage major suppliers to the public sector, and organisations that play a major role in delivering public services, but which are not subject to public sector financial reporting requirements, to include such disclosures on a voluntary basis, such that tracking and explaining senior pay in this way can become a norm across all public services.

RECOMMENDATION 2: Informing the public debate through annual Fair Pay Reports

To support citizen accountability, the Government should commission the Senior Salaries Review Body to publish annual Fair Pay Reports, starting from 2011-12. These reports should set out trends in pay multiples across public services, highlight year-on-year changes and identify organisations that fail to produce meaningful, specific and verifiable explanations for their pay multiples and for changes.

As trends emerge from the SSRB's annual Fair Pay Reports, if the Government judges that pay multiples in individual organisations have shown continued unjustified increases, it should consider intervening directly to control senior pay in the organisations concerned.

If pay multiples continue to rise across public services without adequate justification, as a last resort the Government should restrict organisations' autonomy over senior pay and instead impose centrally-set pay bands.

RECOMMENDATION 3: Re-calibrating the pay of Non-Departmental Public Body chief executives

To address particular concerns that the pay of Non-Departmental Public Body chief executives has

become detached from the responsibilities of their roles, the Government should by December 2011 establish a series of pay benchmarks for NDPB chief executives, following advice from the Senior Salaries Review Body.

Departments should work with the NDPBs they sponsor to assess which pay benchmark is appropriate, given the weight of each chief executive position, and should publish their decisions. The Government should perform a check for consistency once the initial assessments have been made.

Where NDPBs wish to pay a chief executive (incumbent or newly recruited) more than the recommended benchmark, they should obtain Ministerial approval from their sponsoring department.

In addition to the disclosure provisions set out in other recommendations of this Review, NDPBs should also publicly explain in annual remuneration reports any deviation in their chief executive's pay from the recommended benchmark, and the basis of the Ministerial decision to approve.

The Government should ask the SSRB to conduct periodic reviews of the benchmarks, and of their implementation.

Once the scheme is fully operational, it should no longer be necessary for the Chief Secretary to the Treasury to sign off any NDPB salaries in excess of £142,500. Rather, the scheme should provide a more rational basis for Ministerial approvals, including where pay below £142,500 is being proposed but is still excessive for the organisation in question.

RECOMMENDATION 4: From disclosure to explanation: ensuring complete transparency over executive roles and remuneration

To enable citizens to understand executive remuneration and the nature of executive responsibilities, from 2011-12 the Government should require that all organisations delivering public services disclose in precise numbers the full remuneration of all executives, alongside an explanation of the responsibilities of each role and of how executives' pay reflects individual performance.

In parallel with the actions outlined in Recommendation 1, the Government should improve disclosure requirements for public organisations in the following ways:

- Organisations delivering public services must annually disclose the full remuneration of all executives (defined as the chief executive or equivalent, members of the executive board and any other direct reports of the chief executive).
- Executive remuneration must be disclosed in actual numbers, and broken down into base salary, allowances, variable/performance pay, and the cash value of benefits-in-kind.
- Employer contributions to Defined Contribution pension schemes for executives should be disclosed. For executives who are members of Defined Benefit pension schemes, any additional pension rights purchased for them by their employers should also be disclosed.
- Alongside these disclosures, organisations should provide a clear, meaningful explanation of executive pay, in terms easily understandable by the public. Organisations should explain how executives' remuneration relates to the weight of executive roles, including the organisation's characteristics and the role's level of accountability.

- Organisations should also disclose what proportion of executives' base salaries are variable according to performance, alongside an explanation of the basis upon which their performance is assessed.

RECOMMENDATION 5: Enabling citizen analysis of executive pay

From 2011-12, the Government should require public organisations to submit executive pay data through an online template, and make this data available on data.gov.uk, to allow citizens to access and analyse this data and thus have the information required to hold public service organisations to account.

The Government should request that the National Archives develop a template to be used in the capture of all disclosures on executive pay, ensuring that all the data captured is available in a consistent and reusable format.

The Government should instruct data.gov.uk to host this template and make the information gathered through it available to the public according to standard data.gov.uk practice.

Government departments should require bodies and sectors in which they have an interest to complete this template on an annual basis alongside their remuneration reports, for the year 2011-12 onwards.

RECOMMENDATION 6: Abandoning arbitrary benchmarks for public service pay

Once this framework of recommendations is in place, the Government should refrain from using the pay of the Prime Minister or other politicians as a benchmark for the remuneration of senior public servants, whose pay should reflect their due desert and be proportional to the weight of their roles and their performance.

RECOMMENDATION 7: Preventing rewards for failure through earn-back pay for senior public servants

To allow pay to vary down as well as up with performance, all public service executives should have an element of their basic pay that needs to be earned back each year through meeting pre-agreed objectives.

The Government should by September 2011 bring forward proposals for Senior Civil Service pay to include an element of base pay at risk, and should encourage the application of earn-back pay to other organisations delivering public services. This earn-back should be conditional upon meeting pre-agreed objectives; excellent performers who go beyond their objectives should be eligible for additional pay. To be effective, the at-risk element must exceed 10 per cent of basic salary.

The scheme will need to be phased in, in order to avoid adversely impacting current employees and avoiding contractual difficulties

RECOMMENDATION 8: Extending earn-back pay to high performing middle managers

To identify and reward high fliers, once earn-back pay has been implemented at the most senior levels, Government departments and other public service organisations should consider offering this pay structure to middle managers on an opt-in basis.

RECOMMENDATION 9: Sharing the rewards of greater productivity

To prevent executives monopolising the rewards of productivity increases, and allow all employees who have contributed to share the benefits, government departments should identify ways of offering gainsharing schemes linked to achievement of the efficiency aspects of their business plans. The Government should also explore options for gainsharing schemes across public services more widely.

RECOMMENDATION 10 : Opening up opportunities for future generations of public service leaders

To increase the supply of candidates for top positions and reinforce public service management as a career, the Government should facilitate greater opportunities for managers to move across different public services, and between the public and private sectors.

By the end of 2011 the Government should establish a single online portal for advertisements and applications for public service management roles, and work with major public service employers to establish a passport scheme for middle and senior managers across public services.

The online portal should include a repository for potential applicants to upload CVs.

The passport scheme should be designed to encourage employers to look more widely when recruiting, and feature organisations from a range of sectors – public and private – making commitments to:

- supplying adequate induction and support to entrants from other sectors;
- arranging joint training and development schemes focused on leadership and transferable skills;
- relying upon greater use of secondments and employee exchange schemes (minimising personal financial barriers to movement);
- advancing the use of existing professional groups; and
- hosting regular cross-sectoral networks.

The Government should drive and prioritise the ongoing collaboration between public sector graduate recruitment and development schemes. Important elements where greater collaboration could lead to real benefits are:

- integrating recruitment and selection processes;
 - emphasising transferable skills within induction programmes;
 - developing a common core competency profile that will equip graduates with genuine generalist skills for careers spanning public services;
 - promoting opportunities for rotations across different workforces as part of the graduate package;
 - supporting the Local Government scheme in developing internship opportunities - along the lines of existing NHS and Civil Service schemes; and
- reducing the barriers to greater rotation between schemes created by differences in employment conditions.

RECOMMENDATION 11: A Fair Pay Code

To embed fairness principles and ensure fair process in executive remuneration, all public service organisations should adopt the Fair Pay Code proposed by this Review. Government departments should by July 2011 bring forward proposals for the application of this Code to all bodies and sectors in which they have an interest.

RECOMMENDATION 12: Tracking pay multiples across the economy

To make tracking pay multiples normal practice across the economy, as part of its commitment to improve corporate reporting, the Government should require listed companies to publish top to median pay multiples in their annual reporting from January 2012.

The Senior Salaries Review Body should collate and publish the multiples in a similar format to the one used for public sector leaders.

In reviewing corporate accountability and transparency requirements, the Government should also consider how clearer explanation of executive pay by private companies can be achieved.

The government, including local government, should use their influence as a major procurer with all major private sector contractors and suppliers to see that they observe the Fair Pay Code.

ANNEX B

**SCOTTISH GOVERNMENT RESPONSE TO FINANCE COMMITTEE'S DRAFT
BUDGET REPORT: PAY**

34. The Committee notes the possibility of “modest increases” in public sector pay and seeks clarification from the Scottish Government on whether this has been accounted for in setting out its spending plans for the years covered by the spending review.

Modelling of the implications of various pay scenarios formed part of the Government's consideration of future spending plans. This does not extend to determining the application of any policy centrally and at this stage what individual public bodies should spend on their salary costs beyond 2012-13 – clearly that would be inappropriate, given the role that individual employers have in reaching agreement on pay at a local level and reflecting local circumstances and given the relationships in some sectors with UK pay arrangements. It would also pre-empt future pay policy.

The focus in the spending review on public service reform, efficiency, preventative spending and support for economic recovery is designed to support the future affordability of our public services, including pay costs.

The Cabinet Secretary for Finance, Employment and Sustainable Growth announced the 2012-13 Public Sector Pay Policy on 21 September. In view of the tough decisions the government has had to take in light of the cuts imposed by the UK Government, we have considered it necessary to continue with the current pay freeze for a second year. Within this, we are continuing to work to make sure that pay is fair and non-discriminatory and as such the policy provides flexibility for public bodies to provide particular support for their lower paid staff.

37. The Committee would welcome the views of the Scottish Government on the findings of the Hutton report prior to the Committee's meeting on 25 January 2012.

The Scottish Government notes that the recommendations in the Hutton Review of Fair Pay in the Public Sector are aimed at a much larger number and wider range of public bodies and UK Government Departments than is the case in Scotland – around 480 but reducing to around 230 in due course. In Scotland there is one ‘department’ (the Scottish Government) and 37 Chief Executives covered by Pay Policy for Senior Appointments. The Scottish Government considers that in Scotland, the Pay Policy for Senior Appointments – as updated for 2012-13 and published in September this year – already reflects the terms or spirit of many of the recommendations in the report. However, the Government is considering the general principles highlighted by the review and Will Hutton's specific recommendations, as we look ahead to the development of future pay policy in Scotland.

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Convener – Finance Committee
Scottish Parliament
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18 January 2012

Dear Convener

One of the recommendations in the Finance Committee's report of the 2012-13 Draft Budget comments: *The Committee would welcome the views of the Scottish Government on the findings of the Hutton report prior to the Committee's meeting on 25 January 2012* (paragraph 37). I have already responded to all the Committee's recommendations but I believe it would be helpful to provide the Committee separately with some further comment on our views on Will Hutton's recommendations.

The Scottish Government will of course reflect carefully on the Hutton report, as it considers future pay policy in Scotland. However, it has to be borne in mind that the Hutton report recommendations are aimed at a much larger number and a wider range of public bodies and UK Government Departments. In Scotland there is one 'department' (the Scottish Government) and 37 Chief Executives covered by our Pay Policy for Senior Appointments.

Annex A to this letter sets out information about the current position in Scotland relative to the key recommendations made in the Hutton report. A number already apply in Scotland through the application of our Pay Policy for Senior Appointments (available at: www.scotland.gov.uk/Topics/Government/public-sector-pay/senior-appointment-pay).

It might be useful to provide a summary of how the remuneration package for a Chief Executive of a Scottish NDPB is developed. The first element is an assessment of the weight of the Chief Executive post using a recognised evaluation system and this determines the Band in the Chief Executive Pay Framework in which the Chief Executive would sit. There are four bands (Bands 1, 1A, 2 and 3) - which currently have the added advantage of an approximate read across to the Senior Civil Service (SCS). This allows comparison of NDPB Chief Executive remuneration proposals with other NDPB Chief Executives as well as similarly weighted SCS Chief Executives of Scottish Government Agencies, etc.

The second element is that the appropriate labour market is identified from which comparator salaries at the same weight of post should be taken in order to determine a

proposed pay range maximum. This maximum should be no more than the median of salaries in the relevant labour market and should lie within the maximum (and no more than the ceiling) of the relevant Pay Band in the Chief Executive Pay Framework. Any proposals to change the Chief Executive Pay Framework and Banding arrangement for public bodies should be considered on the basis of whether the result would be simpler and more transparent: it should be any less objective nor create more areas for dispute, for example of over banding or salary levels.

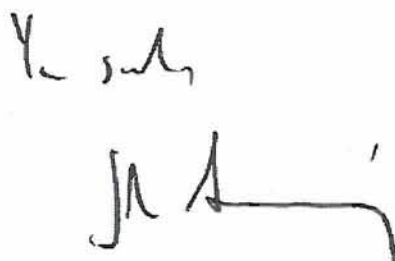
The expectation under the Pay Policy for Senior Appointments is that Chief Executives should be remunerated by way of a pay range rather than spot rate as this provides a performance-related element to pay. In addition, there may be provision for a non-consolidated performance payment arrangement (although under the 2011-12 and 2012-13 Pay Policy for Senior Appointments, access to such has been suspended). All Scottish Chief Executives covered by the Pay Policy for Senior Appointments are on pay ranges (though some are at the maximum), whereas those Chief Executives subject to the UK Government appear to be predominantly on spot rates. I am aware that having Chief Executives on pay ranges may add complications to any 'earn back' proposals. Any change in the remuneration arrangement (for example, the introduction of any 'earn-back' element) must either be done with the consent of the incumbent Chief Executive (such as at a pay review) or on new appointment, so any changes would take some time to filter through all Chief Executive appointments.

Chief Executive remuneration proposals, reflecting their organisation's unique business needs, are developed by the public body concerned, in conjunction with their sponsor team, in line with a published Pay Policy. The proposals are then subject to scrutiny and approval by a group external to that body (in our case, the Scottish Government's Remuneration Group) who can escalate exceptional matters to Ministers for decision.

All names and salary details of members of senior leadership teams are published on respective public bodies' websites and links are provided from the Scottish Government's Public Sector Pay webpages (www.scotland.gov.uk/publicsectorpay).

The current senior pay system in Scotland is relatively straightforward and, in our view, already meets a large number of the recommendations made in the Hutton report (and other recent reports, such as the Senior Salaries Review Body report on a pay structure for NDPB Chief Executives, published in July 2011). My officials are currently giving consideration to the work that will be required over the coming months to support Ministers in our consideration of next steps on all aspects of public sector pay, as we look at the implications of the likely emergence in 2013-14 from the current pay freeze.

In the meantime, I look forward to following your session with Mr Hutton at the Committee on 25 January.

A handwritten signature in black ink, appearing to read 'John Swinney', with a stylized flourish at the end.

JOHN SWINNEY

HUTTON REVIEW OF FAIR PAY IN THE PUBLIC SECTOR

1. In June 2010, the UK Government commissioned Will Hutton to look at Fair Pay in the Public Sector. The review was to investigate pay across the public sector and make recommendations on a framework for fairness in public sector pay. The Scottish Government asked that the review took into account pay in Scotland, but the report is not binding in Scotland
2. The final report of the Hutton Review of Fair Pay in the Public Sector was published on 15 March 2011. The full report (132 pages) is available at: www.hm-treasury.gov.uk/indreview_willhutton_fairpay.htm. The report makes recommendations for a new settlement for public sector leadership in which senior public servants' pay will be directly linked to their performance and will be explained transparently to the public. In return, public service leaders are entitled to expect improved public appreciation of the responsibilities of senior public service roles and the ethos of public service that motivates them.
3. The principal features of the new settlement Will Hutton proposed for senior public service pay are listed below. As noted in the covering letter, the Scottish Government will consider the Hutton report and a range of other issues as it takes forward the development of future pay policy. However, a note of key points to consider from a Scottish perspective in relation to the principal features is provided in italics below):

Earn back pay: Senior public servants' pay should be more strongly linked to their performance through a system of 'earn back' pay. Under this system, executives will have an element of their basic pay 'at risk', to be earned back each year through meeting pre-agreed objectives. This will allow pay to vary down as well as up with performance and ensure that public services do not offer rewards for failure.

Scottish Government: *It is acknowledged (including by the UK Government) that revising a Chief Executive's contract could not be done unilaterally but only with the agreement of the Chief Executive concerned (such as at a pay review) or on a new appointment.*

The proposals entail making the top 10% of a Chief Executive's basic consolidated pay subject to a [further] performance assessment (and potential third party approval). This may be an alternative to a non-consolidated performance payment (bonus) arrangement, but is not mutually exclusive. A potential concern might be that this may push up pay from the '90% pay level'. If a third party (beyond the employer / employee relationship) were also involved, then this could complicate the approval process; there remains the question of who in the Scottish Government or other third party would be best placed and sufficiently knowledgeable to be able to comment on the performance related pay element; and this could bring the Scottish Government or other third party into conflict with the employer / employee contractual relationship (a concern expressed by a number of Chairs / Chief Executives already). These issues are of course not specific to Scotland.

Improved Transparency: all public service executives' full pay should be disclosed each year, along with an explanation of how it relates to job weight and performance.

Scottish Government: *Public bodies' annual reports publish details of the remuneration of the Chief Executives and directors. The Scottish Government also publishes links to each NDPB / public corporations' 'disclosure' webpages on which the names and salary details of members of senior leadership teams are disclosed (basic salary in £5k bands though not bonus amounts) – see: www.scotland.gov.uk/Topics/Government/public-sector-pay/disclosure-of-salaries.*

Bonus figures are not normally published (though some public bodies publish this information in their annual reports). Consideration of the Data Protection Act (DPA) would be required should there be moves to publish more than simply bonus amounts. Likewise, DPA and copyright issues would need to be taken into account if consideration were to be given to disclosing the results of job evaluations for Chief Executive posts, particularly if a commercial contractor was used in the assessment.

No Arbitrary Benchmarks: The Government should not benchmark senior public servants' pay against that of the Prime Minister, and should not impose a fixed limit on pay multiples (such as 20 to 1). The multiple of Chief Executive to workforce median pay should be published each year, and any changes explained.

Scottish Government: In Scotland, comparisons are sometimes made between Chief Executives' salaries and that of the First Minister's. We note that Mr Hutton has now dropped the 20:1 multiple (highest paid: lowest paid) limit (though he recommends the multiple of Chief Executive to workforce median pay should be published each year and any changes explained). The process for determining a Chief Executive's remuneration in Scotland is summarised in the covering letter.

The Scottish Government notes that HM Treasury has issued a Financial Reporting Manual (FReM) Exposure Draft consulting, for application to the annual accounts of central government bodies, on another aspect of Hutton's recommendations: the publication of the median employee salary alongside directors' pay in the Remuneration Report of a company, public body or local authority. This additional disclosure would apply to the accounts of the Scottish Government, its public bodies and local authorities. The proposal has not yet been agreed by the Financial Reporting Advisory Board and timing is therefore uncertain but it could apply to the annual accounts for 2011-12.

An Informed Debate on Senior Pay: Citizens need to understand public service executive pay in the context of job responsibilities. To support this informed debate, the Senior Salaries Review Body should publish Fair Pay Reports each year, detailing pay multiples across public services.

Scottish Government: We note this is addressed to the SSRB. The Scottish Government already publishes its detailed pay policies on its website (www.scotland.gov.uk/publicsectorpay) and NDPBs and public corporations already disclose the names and salary details of senior staff on their respective websites (via links from the Scottish Government Public Sector Pay webpages). Information on pay for Senior Civil Service staff in the Scottish Government at Director level and above is also available on the Scottish Government website (www.scotland.gov.uk/About/scs-salary-data).

Fair Pay Across the Economy: To make tracking pay multiples normal practice across the economy, Will Hutton recommends that Public Limited Companies (PLCs) should also be required to track and publish their pay multiples – and the Government should consider commissioning annual Fair Pay Reports on PLCs as well as public service organisations.

Scottish Government: This is addressed to the UK Government.

ANNEX C

ECONOMY, ENERGY AND TOURISM COMMITTEE REPORT ON THE SCOTTISH SPENDING REVIEW 2011 AND DRAFT BUDGET 2012-13: PAY POLICY

44. The Draft Budget sets out the Scottish Government's intention to freeze public sector wages in 2012-13, which, it argues, will help to maintain employment levels. Professor John McLaren pointed out that—

“when people become unemployed, they start to lose their skills, and the more they lose their skills, the more difficult it is for them to get back into employment when jobs are available. A pay freeze or even a move to having more part-time jobs, will keep people in employment and maintain their skills”.

45. Jim Boyle of the Poverty Alliance argued for a living wage across the public sector and also to be built in as a condition of public contracts. He argued that the Draft Budget lacked vision when it came to selecting the right priorities and choices for a fairer society.

46. Professor John McLaren emphasised the need to debate policy on public sector pay publicly as it “will not happen unless people buy into it.” A written submission from STUC said “There is nothing in this Budget to assist hard pressed public sector workers currently suffering from pay freezes and increased pensions contributions”, while UNISON said that the freeze “means that those who remain in work have less to spend which is again impacting growth in the private sector” and advised the Committee to “to get beyond the rhetoric of blaming Westminster and hold the Government to account for their spending choices”.

47. The majority of the Committee recognises the challenges facing public sector budgets within the current UK Government Spending Review arrangements and accepts the Scottish Government's decision to freeze public sector pay in 2012-13. However, beyond this date, the Committee would like to see further discussions and consultations in order to take the staff and unions with them if the Scottish Government chooses to extend a pay freeze beyond this period.

48. However, a minority of the Committee recognises the challenges facing public sector budgets within the current UK Government settlement arrangements and notes with regret the Scottish Government's decision to continue to freeze public sector pay in 2012-13. The minority of the Committee therefore recommends that the Scottish Government place a high priority on ending the pay freeze at the earliest possible time. The minority of the Committee calls on the Scottish Government to hold further discussions with staff and unions to apprise them of the timescale for the ending of the pay freeze.

49. The Committee recommends that, for as long as the pay freeze is in place, the threshold for protection from this measure – an income of £21k or below – should be reviewed on an annual basis. The Committee further recommends that the Scottish Government acts to address the bonus culture which still

exists within some parts of the senior civil service and in some Government agencies.

The social wage

50. The Draft Budget sets out the Scottish Government's intentions around what it describes as the social wage. It says—

“the Social Wage asks those who work in the public sector to accept pay restraint while the Government will support households through measures such as the council tax freeze, free education and the abolition of prescription charges. Through the choices in this Spending Review, we are acting to create new economic opportunities, protect household income, support frontline services and improve our environment. Our initiatives aim to help households facing pay restraint, a necessary measure to protect jobs and assist the economy”.

51. Stephen Boyd of the STUC observed that free prescriptions and a council tax freeze were unlikely to “fill the gap” for a public sector worker earning £25,000, but he welcomed the concept of a social wage and said that it represented a “decent start” on the Scottish Government's stated intentions around solidarity, equality and cohesion. Jim Boyle of the Poverty Alliance also welcomed the social wage as the starting point for a process which would promote and protect the rights of citizens with respect to healthcare, dignity and employment. The Cabinet Secretary for Finance, Employment and Sustainable Growth said “the council tax freeze has a proportionately greater impact on those who have low incomes than it does on those who have higher incomes”.

52. The Scottish Government's National Performance Framework sets out the following indicators and targets:

- Indicator: solidarity, target: To increase overall income and the proportion of income earned by the three lowest income deciles as a group by 2017.
- Indicator: cohesion, target: To narrow the gap in participation between Scotland's best and worst performing regions by 2017

53. Referring to the £2 billion which, it is estimated, will be removed from the Scottish Economy over the life of this Parliament through the UK Government's welfare reform proposals, Jim Boyle said—

“a social wage will not make up for that loss. The other factor in that is that that money that the poorest people get is spent within their communities. If we take £2 billion not just out of the poorest communities but out of the Scottish economy, what effect will that have?...that is where the real challenge for cohesion, equality, solidarity and the social wage will come. What will the Scottish Government do when the welfare reforms start to hit the poorest in society?”

54. The Committee welcomes the concept of the social wage. However, the Committee looks forward to more detail on the concept and greater clarity on how the measure will support solidarity and cohesion, and reduce inequality particularly during times of economic hardship.

EXTRACT FROM BUDGET ADVISER PAPER ON DRAFT BUDGET 2012-13

Budget. This issue has previously been raised in reports to the Parliament and would seem to be relevant for the Equalities Report.

The Draft Budget does not reference the imminent change in Council Tax Benefit arrangements arising from the UK Welfare Reform Bill. In England, council tax benefit is to be replaced by grants to local authorities in April 2013. In Scotland, the grant will be made to the Scottish Government. The value of the Council Tax Benefit in Scotland in 2009-10 was £368 million. Although this change to localised rules governing CTB has been criticised, for example by the Institute of Fiscal Studies, nevertheless if it proceeds, it will have significant implications for local authority funding over the course of the spending review period.

Public Sector Pay

Control over public sector pay continues to be a key part of the budget strategy. The importance of controlling pay is due to its dominant role in the Scottish budget. It is clear that this is the view of the Cabinet Secretary.

"Pay is a significant issue, given that it accounts for at least 60 per cent of Scottish departmental resource expenditure - in fact, it is the key variable. The pay policy that we will set out will be driven by the budget numbers that we receive. It will be a heavily constrained pay policy. ... I think there will be a loss of public sector employment in the years going forward."

John Swinney MSP, Cabinet Secretary for Finance and Sustainable Growth, oral evidence to the Scottish Parliament Finance Committee, 18 May 2010³

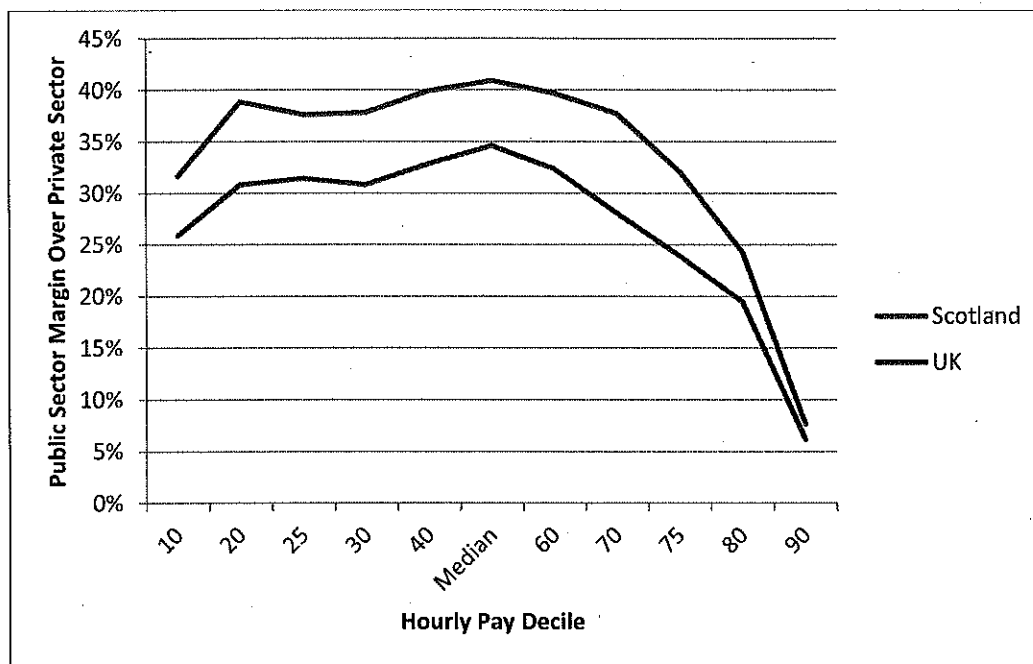
It is also clear that the current pay policy, which protects low paid workers earning less than £21,000 does have differential effects across the workforce. In the Budget Adviser's report on the 2011-12 Draft Budget, it was argued that a freeze on public sector pay for those earning over £21,000 will mainly benefit relatively poorly paid women and younger people. Pay policy also affects differentials between the private and public sectors. Figure 3 shows the margin between the hourly wage of private sector and public sector workers in Scotland and the UK as a whole in 2010. Thus for example if the going rate in the private sector is £10 per hour and in the public sector is £12 per hour, then the margin in favour of the public sector is 20%. These margins are calculated for each earnings decile. So the calculation is done across the spectrum from the relatively poorly paid to the relatively well-paid. The results are shown in Figure 3.

The figure illustrates a number of points. First, hourly pay in the public sector is higher than that in the private sector right across the hourly earnings distribution. Thus, for example, the hourly wage of those in the lowest 10% of earners in the UK public sector have an hourly wage that is 25% higher than the lowest 10% of earners in the UK private sector. Second, the margin between public and private sector pay only starts to fall at around the seventh income decile. It is those in the public sector with the highest pay that have the lowest margin above their private sector comparators. Third, it is clear that the margin by which hourly wages in the public sector exceeds those in the private sector in Scotland is higher than in the UK as a whole. A market-based conclusion from this

³ <http://www.scotland.gov.uk/Publications/2010/07/29082838/18>

finding would be that the productivity of public sector workers must exceed those in the private sector by more in Scotland than in the UK as a whole. If this is not the case, then perhaps public sector workers are earning a "premium" in Scotland relative to those in the private sector. If the latter interpretation is correct, implying a degree of inefficiency in Scotland's public sector, then perhaps existing bargaining arrangements are leading to this outcome. A move towards bargaining at Scottish level might be an appropriate policy response.

Figure 3: Margin of Hourly Earnings in the Public Sector over Those in the Private Sector Scotland and the UK 2010



Source: Annual Survey of Hours and Earnings 2010, Office of National Statistics

The importance of this issue is shown in Table 2, which is drawn from the independent budget review (2010). It firstly shows projections of the reduction in resource DEL that would be available for pay, assuming that the people accounts for 59% of resource DEL. Second, it shows the projected increase in people costs assuming that past trends in pay increases continued. Thus, in 2014-15, the continuation of past trends in pay within the Scottish public sector would have resulted in an increased DEL funding requirement of £2 billion. Clearly, a "pay freeze" consistent with the Cabinet Secretary's current policy will substantially diminish the need for such an increase.

Table 2 Projected Changes in Resources Available for Pay (£m)

£ million, cash terms	2011-12	2012-13	2013-14	2014-15
Impact of Resource DEL projections on resources available to meet the pay bill. This assumes the pay bill continues to account for 59% of Resource DEL.	-320	-230	-200	-260

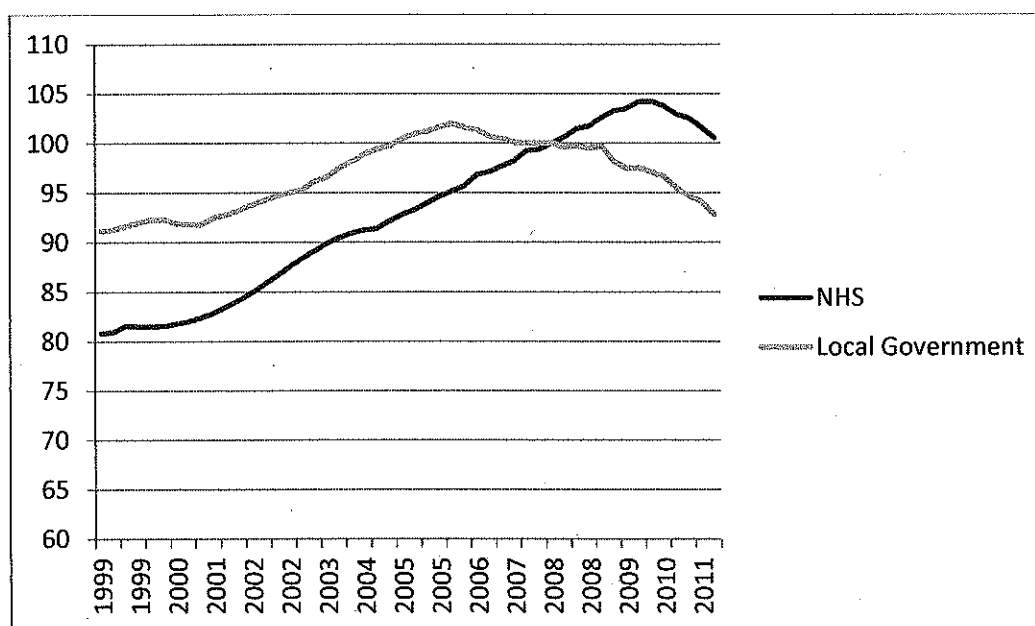
Theoretical pay bill increases, calculated in line with historical movements	+420	+900	+1,430	+2,000
------------------------------------------------------------------------------	------	------	--------	--------

Source: Independent Budget Review (2010)⁴

Public Sector Employment

it is worth noting that public sector employment is already falling in Scotland. This is shown in Figure 4, which plots indices of employment for the Scottish NHS and Scottish local authorities. The indices take the value 100 in 2008 Q1. Two findings are evident. First employment in both sectors has been falling. In fact the reduction in local authority employment predated the beginning of the recession in 2008. The reduction in NHS employment came later and has been milder than the decline in local authority employment. Second, overall employment in the NHS has grown at a much more rapid pace than in Scotland's local authorities. Employment in the local authority sector is now close to where it was in 1999. These outcomes also reflect the growth in the NHS budget relative to that in local government, particularly in recent years.

Figure 4: Employment in the National Health Service and Local Government



Source: Scottish Government

Public Sector Pensions

The Scottish government is to implement the public sector increases in pensions mandated by the UK government. On average, pension contributions will increase by 3.2% over the next three years. The Scottish Government argument is that not to introduce these pension increases would cause cuts in its own budget leading to falls in employment and/or further pressure on public sector wages. It has also been informed by HM Treasury that if it does not introduce the changes, its block

⁴ <http://www.scotland.gov.uk/Publications/2010/07/29082838/6>

grant will anyway be cut. Clearly this is a somewhat unsatisfactory situation. It reinforces the argument that the Scottish Government should be responsible for the pension arrangements of public sector employees in Scotland.

Non-Domestic Rates

Non-domestic business rates bills are calculated by applying the "non-domestic rating multiplier", also known as the Uniform Business Rate, to the rateable value of the property. The multiplier is increased each year in line with the Retail Price Index. Hence yields tend to increase with prices. In recent years, the Scottish Uniform Business Rate has been harmonised with that in England. This is a policy choice.

The Scottish Government is committed to not raising the business rate poundage in Scotland above that in England during this Parliament. In answer to a parliamentary question, John Swinney, the Cabinet Secretary responded:

"The Scottish Government is committed to the Scottish poundage rate not rising above the English poundage rate during the current Scottish Parliament. The calculations underpinning the Draft Budget 2011-12, published on 17 November 2010, were based on a then anticipated inflationary uplift in the poundage rate of 2.5 per cent. The UK Government announced on 14 December 2010 that the uplift for the poundage in England would be 4.6 per cent, and this is now the rate used for the Scottish poundage."

John Swinney, Cabinet Secretary for Finance and Sustainable Growth, Parliamentary Answer, 4th February 2011

This means that local government finance will become increasingly dependent on contributions from non-domestic rate relative to those from council tax. Note however that Scottish Government takes up any shortfall on NDRI receipts. Thus it takes the risk if the receipts do not match the forecast contained in the Spending Review. The burden of funding local government will switch from households towards businesses during the spending review period. This is illustrated in Figure 5, which shows the extent to which revenue from non-domestic rates exceed those from council tax from 2005-06 to the end of the spending review period.

EXTRACT FROM INDEPENDENT BUDGET REVIEW REPORT ON REMUNERATION AND WORKFORCE

Pensions and employers' National Insurance contributions

The Panel suggests that the Scottish Government recognises that changes to the current public sector pension arrangements are essential and almost certainly unavoidable and that it should engage proactively with the work of the Independent Public Services Pensions Commission.

Freeze on recruitment

The Panel suggests that the Scottish Government should consider the immediate implementation of a recruitment freeze across the public sector, with exceptions only granted for essential staff posts. The period of the freeze will be dictated by the success of the action taken above.

Strategic Workforce Planning

The Panel suggests that, if outcomes are to be maintained, the reductions in public sector employment would need to be driven by a set of clear, strategic priorities across all parts of the public sector. One option for the Scottish Government to consider is the rapid development of a clear, strategic and phased workforce plan which sets out a set of priorities/criteria towards which all parts of the public sector can work.

Pay restraint for 2011-12 and 2012-13

The Panel recommends that the Scottish Government applies a pay freeze as the first essential step to constrain growth in the public sector pay bill. Four options have been identified for consideration:

- Option 1: UK option - a two-year pay freeze for public sector workers, from 2011-12, except for those earning £21,000 or less, who would receive at least £250 in these years. At the current time, the UK position appears to be that, where public sector employees are entitled to progression, these payments would be continued;
- Option 2: pay freeze with no threshold for lower paid workers - a two-year pay freeze for all public sector workers, from 2011-12. All progression payments would continue;
- Option 3: freeze on all pay (i.e. including progression) for all public sector workers - a two-year pay freeze and suspension of progression pay for all public sector workers, from 2011-12; and
- Option 4: pay freeze with a threshold for lower paid workers which is either in line with the UK threshold or the Scottish Government's target for reducing poverty and income inequality in Scotland - a two-year pay freeze for public sector workers, from 2011-12, except for the lowest paid as defined by the Scottish Government's solidarity target. Progression payments could be continued or suspended.

Pay restraint for 2013-14 and 2014-15

Assuming any pay freeze would be lifted after two years, further pay restraint would be required to constrain growth in the pay bill. The Panel has identified two options for the Scottish Government to consider for 2013-14 and 2014-15:

- Option A: tight pay restraint with a net increase in the pay bill (including costs of progression) of 2 per cent; and
- Option B: pay award in line with projections for General Government average earnings growth 122 (3.1 per cent in both years).

Recruitment freeze

The Panel suggests that the Scottish Government should consider the immediate implementation of a recruitment freeze across the public sector, with exceptions only granted for essential staff posts. The period of the freeze will be dictated by the success of the action taken above.

Reductions in public sector employment, 2011-12 to 2014-15

The Panel suggests that the Scottish Government and other public sector employers have only two broad options:

- to reduce the average cost per employee - e.g. by freezing pay, adjusting other elements of the remuneration package, reducing hours of work; and/or
- to reduce the number of employees - e.g. through a freeze on recruitment, natural wastage (i.e. non-filling of posts when people leave or retire) or redundancy.

The Panel is of the opinion that both of these approaches will require to be considered. The first option clearly has the ability to constrain growth in the pay bill and hence mitigate the scale and impact of individual job losses and redundancies in the short term.

In 2011-12 (when the budget cuts are anticipated to be particularly severe), the Scottish Government has a choice between:

- a 2.3 per cent to 3.5 per cent reduction in public sector employment, managed as far as possible through natural wastage; or
- a smaller reduction in public sector employment in 2011-12 with the remainder of the gap in the pay bill financed from additional reductions in non-pay bill resource expenditure.

**FINANCE COMMITTEE 2009 REPORT OF INQUIRY INTO PUBLIC SECTOR PAY:
OVERALL CONCLUSIONS AND RECOMMENDATIONS**

The Committee notes that whilst the opportunity for the trade unions to discuss matters with the Cabinet Secretary is welcome, there is no formal negotiating machinery with the Scottish Government.

Whilst the Committee notes the Cabinet Secretary's comments about affordability in the current financial context, the Committee welcomes the focus on addressing low pay. Accordingly the Committee believes that the Cabinet Secretary should demonstrate how low pay is being addressed in policy and in practice. The Committee further believes that, following best practice, the Scottish Government should make clear to NDPBs and agencies that pay increments should be separated from pay increases; that a review is carried out of pay systems that are service related to avoid age discrimination; and that the cost of addressing equalities issues and mergers as a result of public service reform are separated from the annual bargaining agreements.

The Committee commends the suggestion from COSLA of a short term working group, involving the trade unions, to examine the question of low pay in local government. In addition, the Committee looks forward to COSLA developing a policy-based pay structure.

The Committee acknowledges that improvements have been made in the time taken to process and approve pay proposals. However, while recognising the complexities, the Committee believes that there is further scope for improvement. The Committee recommends that the Cabinet Secretary brings forward proposals to address this issue.

In terms of the pay unit's staffing, the Committee is strongly of the view that HR provision must be a core part of the pay policy unit.

The Committee is persuaded of the difficulty in benchmarking and recommends that the Cabinet Secretary looks further at proposals in this regard.

The Committee recommends that the Cabinet Secretary explores what flexibility or discretion can be given to reflect local circumstances, within the context of affordability and equality.

The Committee notes the frustration with the lack of meaningful negotiation at a local level given that the actual negotiation and approval process is with the NDPB and the Scottish Government. The Committee therefore recommends that the Cabinet Secretary explores ways of reducing the number of bargaining areas and the practicability of direct negotiations with other representative bodies involved.

The Committee further considers that it might be useful for the relationships between COSLA, the Scottish Government and trade unions in local government pay negotiations for there to be tripartite discussions when pay is considered as part of the local government settlement.

The Committee is of the view that the policy of paying bonuses to senior appointees should be reviewed; and as each of these particular appointments comes up for renewal, bonus arrangements should be altered or brought to an end in line with the outcome of the review.

Staff group	Pay determining process
Scottish Government (excl. Senior Civil Service), NDPBs, Public Corporations, Departments and Agencies, NHS Senior Management	Scottish Government directly controls through pay policy
Local authority staff (excl. teachers, police and fire)	COSLA
NHS	Scottish Government determines, but usually follows recommendations of UK pay review body
Teachers and associated professionals	Scottish Government determines alongside COSLA and trade unions
Police	Scottish Government determines, but usually follows recommendations of UK pay review body
Fire	Scottish Government determines, but usually follows recommendations of UK pay review body
Senior Civil Service (SCS)	UK Government determines pay
Total	

Finance Committee

3rd Meeting, 2012 (Session 4), Wednesday, 25 January 2012

Fiscal sustainability – universal services

Purpose

1. The purpose of this paper is to provide background information for the round table discussion on the provision and funding of universal services. This is the third of the Committee's discussions under the fiscal sustainability theme. The paper draws to the Committee's attention consideration given to this issue e.g. by the Independent Budget Review (IBR) and during recent budget scrutiny.

2. Those participating in the round table are—

- Robert Black, Auditor General for Scotland
- Paul Brewer, Pricewaterhouse Coopers
- Graeme Downie, National Endowment for Science Technology and the Arts
- Professor Jim Gallagher, University of Glasgow
- Professor Jeremy Peat, Royal Society of Edinburgh
- Dr Andrew Walker, University of Glasgow

3. Written submissions from the Auditor General for Scotland, NESTA, and Pricewaterhouse Coopers are attached at Annex A.

Background

Independent Budget Review

4. The [Report of the Independent Budget Review](#) stated—

'The Scottish Parliament has expanded the provision of free or subsidised public services on a near universal basis since Devolution over a decade ago. Such universal services were introduced in what was an increasing and buoyant public spending context. This has effectively shifted funding responsibility from the individual to the state. Demographic trends are already increasing the cost of such services - and are expected to continue to drive up costs in future.

The Panel believes that the continuing provision of a range of universal services on the same basis as at present is unlikely to be affordable in the face of the projected financial challenges. Alternative approaches should, therefore, be considered as a matter of urgency.'

5. A copy of [chapter 5](#) from the IBR report, which highlights universal services (these being: concessionary travel; free personal and nursing care; prescription charges; eye examinations; free school meals; and tuition fees), is attached at Annex B. A key part of the Panel's consideration was around the alternative approaches such as means testing, limiting entitlement, increasing or introducing charges for services. It sets out possible options and cost savings on the various services.

6. It says in conclusion on this issue that—

‘The operation of free or subsidised public services on a near universal basis over the last 10 years has benefited a wide range of people, including those who might have had the resources to fund them themselves. Unfortunately, demography and other drivers are expected to continue to stimulate demand and inflate costs to levels which appear to be unsustainable. The issue is not one of desirability, but of affordability.

There is a pressing need to review the current approach in order to reduce future inflationary cost pressures and to ensure a more sustainable approach to funding. The Panel considers that there is scope to look again at eligibility, as well as the selective introduction of means testing and user charging for all universal services. This will help to ensure that public services are focused on those with greatest need as well as helping to control future costs.

The Scottish Government should build on the indicative analysis of universal services in this chapter and take forward further, more detailed work as soon as possible to consider savings that could possibly be made within the next Spending Review period, taking account of the impact on those in greatest need. The scale of the savings has the potential to make a significant contribution to filling the projected funding gap.’

Budget adviser papers

7. The IBR referenced the paper by the Committee’s budget adviser, Professor David Bell - [Meeting the Challenge of Budget Cuts in Scotland: Can Universalism Survive?](#) A copy is attached at Annex C. Again, this paper addresses the issue of whether such public services should be universal or means tested.

8. In addition, the extract on universal services from adviser’s [‘standing paper’ on fiscal sustainability](#) is attached at Annex D.

Draft budget scrutiny: Previous and current Finance Committee consideration

9. The previous Committee, in its scrutiny of the draft budget for 2011-12, considered the maintenance of universal services. An extract from that Committee’s [report](#) is provided below—

‘However, despite the recommendations within the IBR panel report that immediate work should be carried out by the Government to “review whether all free or subsidised universal services should be retained in their current form” the Cabinet Secretary has instead chosen within *Draft Budget 2011-12* to “reinforce our social contract with the people of Scotland.”

The Cabinet Secretary elaborated on this social contract in evidence to the Committee—

“We have to consider the projects and proposals that we think are appropriate as part of the social contract that exists in our society. My view, and the Government’s view, is that the first port of call of any programme to reduce public expenditure should not be universal services that have been built up as a consequence of agreement in the Parliament.”

The Committee makes no comment on the proposals from the IBR. However, given the Cabinet Secretary's emphasis on the continued provision of universal services the Committee again invites the Government to be more transparent in explaining how this will have a long-term impact on other aspects of the budget given demographic and other cost pressures.

The Committee also invites the Government to respond to the view that given the emphasis on the "social contract" the primary aim of the draft budget is the protection of services rather than economic growth.

The Committee also asks the Government whether the emphasis on a social contract means that the Commission on the Future Delivery of Public Services will need to work on the basis of prioritising the protection of universal services'.

10. The Scottish Government, in its [response](#) to that Committee's report, stated—

'The Government has been clear about the approach it has taken in proposing a budget for 2011-12, which incorporates many of the IBR's recommendations, and its longer term vision for Scotland's public services, which will clearly be informed by the outcomes of the work of the Christie Commission on the Future Delivery of Public Services, our consultation on the future of police and fire services, the Green Paper we have published on Higher Education funding and a range of other work streams across portfolios.

The Draft Budget 2011-12 document makes clear how the Scottish Government's commitment to its social contract with the people of Scotland is aimed at delivering a joined up approach that will support economic growth and protect frontline services.

In section 1 of this response the government has set out how the budget prioritises economic growth and supports economic recovery. This is amplified in Chapter 2 of the Budget document'.

11. This Committee considered, as part of its scrutiny of the spending review 2011 and draft budget 2012-13, the provision and funding of universal services. The Committee's [report](#) (paragraphs 46-51) highlighted the Auditor General for Scotland's estimated cost of £870 million to pay for universal services. In response to questions from the Committee on the sustainability of universal services, the Cabinet Secretary for Finance, Employment and Sustainable Growth said—

"When a dialogue takes place in a period of spending pressure, people almost automatically say that the first thing we must do is stop universal benefits. The fact that our three-year spending review does none of that demonstrates that we believe the concept to be sustainable."

12. The Committee, in its report, highlighted calls (e.g. from the RSE, West Lothian Council, Centre for Public Policy for Regions) for a debate on the future provision and funding of such universal services.

Christie Commission

13. The Commission on the Future Delivery of Public Services highlighted the provision of universal services in its [report](#). In particular, it drew attention to the report by the IBR. When considering the issue of improving performance and reducing cost, the Commission stated—

‘However, given the scale of the budget reduction imposed, we believe that our work needs be considered alongside the IBR and the conclusions and recommendations of that Report should remain part of the ongoing debate on public services. For instance, the issue of universality is usually posed as free provision for all versus means testing, whereas there are several other mechanisms - such as varying the age of eligibility - which can also reduce the spend.

We think it more logical to examine each area and option on its individual merits in terms of the positive effect on society, impacts on the budget and opportunity costs rather than supposing all proposals - on welfare or taxation - must be subjected to an identical approach.

We call on the Scottish Government to support long-term planning by ensuring all operating plans and budgets for public services:

- are directed towards outcomes and support integrated models of service provision;
- are made on the same multi-year basis; and
- are informed by credible analysis that illustrates the long-term fiscal consequences of current approaches’.

14. The Commission also stated—

‘Contentious issues such as the continuation of universal entitlements must be considered openly and transparently, rather than in the current polarised terms.’

National Performance Framework

15. It is suggested that each of the 16 National Outcomes relate in some way to the provision of free universal services. With regards the 50 National Indicators, again, policies around the provision of free universal services may be used by the Scottish Government in measuring performance with regards to individual indicators. How this is done specifically may be an issue which the Committee pursues through future consideration of the NPF and its impacts.

Audit Scotland

16. Audit Scotland published its report [Scotland's public finances: Addressing the challenges](#) which provided an overview of how public bodies are beginning to respond to the challenge of reduced expenditure while ensuring long-term sustainable public services. An extract from this report on universal services is attached at Annex E.

Conclusion

17. The Committee is invited to consider the above issues.

Fergus D. Cochrane
Senior Assistant Clerk to the Committee

Scottish Parliament Finance Committee discussion on universal services

Written submission by Audit Scotland on behalf of the Auditor General for Scotland

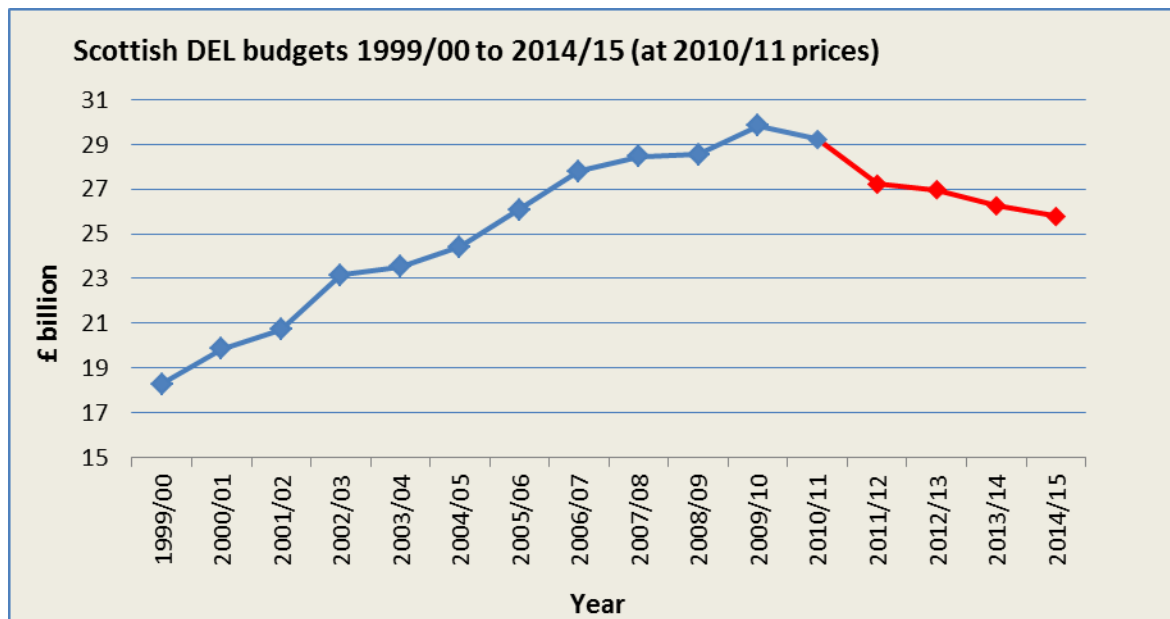
Introduction

The Auditor General for Scotland secures the audit of the Scottish Government and other public bodies in Scotland, except individual local authorities. He investigates whether bodies achieve the best possible value for money and adhere to the highest standards of financial management. The Auditor General is independent of the Scottish Government and the Scottish Parliament.

Audit Scotland is the statutory body which carries out audits and investigations for the Auditor General for Scotland and the Accounts Commission. This paper is based on the content of recent Audit Scotland reports which have been presented to Parliament.

The financial context

The Scottish budget increased by an average of five per cent per annum in the decade since devolution. The Scottish Spending Review 2011, however, indicates that the DEL budget in 2014/15 will be lower in real terms by 11 per cent compared to 2010/11.



The Audit Scotland report *Scotland's public finances: addressing the challenges*, published in August 2011, highlighted that public bodies face increasing demand and cost pressures for their services and this is likely to continue in the future. An ageing population, the effects of the recent recession and the heightened expectations of the public, all increase the demand for public services. There are additional cost pressures and financial constraints, including maintenance backlogs and annual payments for revenue financed capital projects.

The need to reduce costs provides public bodies with an opportunity to reform and streamline public service delivery. However, in doing so, bodies must focus on long-term financial sustainability.

This requires a clear understanding of the organisation's costs, including how different activity levels affect costs, and a clear methodology for setting budgets based on priorities in relation to services and outcomes. It also requires the public sector to consider new means of raising revenue which can help to sustain important services.

Much better management information is needed to make difficult decisions, control costs, drive productivity improvements and monitor performance. Many of our reports highlight that organisations have inadequate data to understand the cost, activity and quality of services they deliver. This lack of information can make it difficult to identify their priorities and assess whether their services are providing value for money. In relation to the value for money question, it is important to have good information about who benefits from these services.

Universal services

The Scottish Government remains committed to a number of universal public services such as free prescription charges, free eye tests, concessionary travel and free personal and nursing care. These services are demand led, making it difficult to estimate their future costs. However, given the expected rise in the number of older people in Scotland, the likelihood is that, unless changes are made to areas such as eligibility criteria, growing demands for these services will lead to increases in costs.

In 2010/11, the combined cost of free personal and nursing care, free prescriptions, free eye tests and the national concessionary travel scheme was around £870 million. These costs are rising. For example, in October 2010, our report on *National concessionary travel* indicated that, unless controlled, annual costs of this scheme could increase from £200 million in 2009/10 to between £216 million and £537 million by 2025, through a combination of increased usage and rising travel costs.

The Auditor General and commentators have questioned whether, in an environment in which public spending is under severe pressure, the universal provision of services free at the point of delivery should be reconsidered. For example, the Independent Budget Review Commission recommended that all universal services should be reviewed to see if they should be maintained in their current form, focussing on changes in eligibility criteria, the introduction of charges and to ensure that those who need these services most are not disadvantaged.¹

It is, of course, a policy matter for the Scottish Government and the Parliament to determine eligibility criteria for universal services and whether users of such services should be asked to make a contribution to their costs. If there were to be a move towards co-payment financing of personal services this could allow limited public funds to be stretched further. However, there is then a question about ability to pay, or means testing as it is commonly called. Some countries have successfully established a culture in which universal benefits have wide support, whereas others rely heavily on means testing. Some of the issues to be considered include:

- **Stigma.** A programme benefitting only those on low incomes may carry a stigma on its use and be considered by some to be demeaning.

¹ *Independent Budget Review*, The Report of Scotland's Independent Budget Review Panel, July 2010.

- **Poverty trap.** Means tests, particularly those involving sharp cut-offs, can result in perverse incentives at the boundaries. For example, they can discourage saving and income earning if they result in a person no longer being able to qualify for free services.
- **Access.** Means tests, especially complicated ones and ones that differ between programmes and different levels of government, may complicate access to services. Individuals may not easily know if they qualify and may also qualify for some services but not for others.
- **Administrative costs.** Means tests are likely to increase administrative costs, due to the work of verifying that the tests are satisfied. It can be argued, however, that these costs can be offset by the savings resulting from reduced payouts under means testing.
- **Entitlement/promises.** If means testing is introduced for an existing and previously free service, the reduction in benefits can be seen as a breach of promise and entitlement of the service.

If universal services are to be continued with, then the following features need to be in place:

- The Scottish Government needs to ensure there are clear objectives associated with each service and the benefits which they are intended to deliver.

Our report on *National concessionary travel* indicated that when the scheme was introduced, there was not a sufficiently clear statement of its objectives or what it was supposed to achieve. We recommended that the Scottish Government and Transport Scotland should develop performance measures which would allow the impact of NCT to be assessed against the strategic objectives set out in the National Performance Framework.

- Good information must be available on the costs of each service, including how costs may change due to forecast changes in demand.

Projections show that over the period 2008 to 2033 the number of people aged 60 and over will increase by 50 per cent from 1.17 million to 1.75 million, with the number of people aged 75 and over set to almost double. As universal services are most often available to older people, it is important that this demographic change is taken into account when projections of the future costs of these services are being made. Our report *A review of free personal and nursing care*, published in January 2008, found that monitoring of the financial impact of the policy had been limited and the longer-term cost projections for free personal and nursing care had not been updated between 2001 and the time of our report.

Cost projections must also take into account the potential for universal services to reduce costs elsewhere. For example, eye tests can be used to prevent longer-term eye problems, and to indicate other health issues such as diabetes which, if tackled promptly, can safeguard the quality of life and reduce the need for more expensive treatment at a later date.

- There must be clearly defined eligibility criteria which are understood by administrators of the schemes

A review of free personal and nursing care indicated that the legislation and guidance was ambiguous or unclear about whether personal care is a universal entitlement for older people, based on an assessment of need, or whether councils had discretion to manage demand and prioritise services within their available resources. While the Scottish Government has since provided clarification on entitlement, the principle of having clearly defined eligibility criteria is applicable to all universal services.

The appendix to this paper provides short extracts from relevant Audit Scotland reports.

Audit Scotland

January 2012

Appendix – What we said in our reports

A review of free personal and nursing care, January 2008

"The legislation and guidance are ambiguous or unclear in some key areas including in particular: whether personal care is a **universal entitlement** for older people, based on an assessment of need, or whether councils have discretion to manage demand and prioritise services within their available resources"

"The Scottish Government and councils should continue to work together as a matter of urgency to: Clarify current ambiguities with the policy. This includes making clear whether personal and nursing care is a **universal entitlement** to older people based on an assessment or whether locally available budgets and resources can be taken into account. There is also a need to address about the inconsistency between the legislation and guidance around food preparation. They should then ensure that the policy is consistently applied across Scotland from now on."

"Although FPNC is a **universal policy**, councils differ in their use of eligibility criteria and waiting lists. This means that older people may receive different levels of service depending on where they live."

National concessionary travel, October 2010

"Better targeting of the scheme: The Local Government Association in England reported that the national concessionary fares scheme in England was an inefficient and high-cost way of delivering its objectives and that better targeting at the scheme's intended beneficiaries (eg, those who were socially excluded) would generate savings. In Scotland, some people use NCT to travel to and from work. Some of these people could be at the peak of their earning potential, while others may have to work to supplement their income. The number of people with an NCT pass in employment, and how much they earn, is not known. However, at the last census there were over 223,000 people in Scotland aged 60 and over who were still in employment. Based on average usage in 2009/10, removing these people from NCT could save around £34 million a year."

There are also some disabled people who were eligible for concessionary bus travel under some of the previous local schemes but who are not now eligible under NCT. This is because NCT requires a higher level of disability to qualify than some previous schemes. For example, people on lower levels of disability living allowance are no longer entitled to concessionary travel. These people may need guidance and supervision when moving around or may have learning difficulties. The number of people adversely affected is not known but the Learning Disability Alliance Scotland has estimated that around 12,000 people may be affected. There is a risk that some of these people may be more socially excluded than some NCT users who are relatively fit, able bodied and well-off."

Scotland's public finances: Preparing for the future, November 2009

"There are more free services and the costs of these will rise.

The Scottish Government is committed to a number of universal public services, which are not paid for by users and where the costs are increasing. These services are demand led, making it difficult to estimate their future costs. Changes in Scotland's population will increase demand for these services, placing pressure on their long-term affordability.

Free personal and nursing care (FPNC) for older people was introduced in July 2002 through the Community Care and Health (Scotland) Act. In 2008, Audit Scotland highlighted a growing shortfall in Scottish Government funding for the policy, which was confirmed in the subsequent review by Lord Sutherland. The Scottish Government has provided an additional grant of £40 million to councils for the two years to 2009/10. The total cost of providing FPNC increased on average by 15 per cent each year between 2003/04 and 2006/07. If this trend continues, projected costs for 2009/10 and 2010/11 will be around £489 million and £562 million respectively.

In December 2007, the Scottish Government announced that prescription charges would be phased out until fully abolished in April 2011. The estimated cost of this is £17 million, £24 million and £32 million, in the three years from 2008/09 to 2010/11. It is estimated that the cost of providing prescriptions free of charge will be £57 million in 2011/12.

In April 2006, free eye examinations were introduced for everyone in Scotland. In 2006/07, the first year of the new policy, eye examinations increased by 53 per cent to 1.5 million with the number of examinations now approximately 1.6 million. The Scottish Government estimates that providing free eye examinations will cost £87.4 million in 2009/10 and £91 million in 2010/11.

The concessionary fare travel scheme was introduced in April 2006 and provides free bus travel throughout Scotland for older and disabled people. The estimated cost is £187.4 million in 2009/10 rising to £189.4 million in 2010/11."

Scotland's public finances: Addressing the challenges, August 2011

"Many public services are demand led and public bodies have limited or no control over this demand. For example, access to universal public services such as free personal and nursing care and concessionary travel is open to all eligible people and demand can only be influenced through changes in government policy. However, more control can be exercised in other areas such as access to further and higher education, where demand can be controlled through the number of student places that universities and colleges make available."

"The Scottish Government remains committed to a number of universal public services such as free prescription charges, free eye tests, concessionary travel and free personal and nursing care where the costs are increasing. These services are demand led, making it difficult to estimate their future costs. However, given the expected rise in the number of older people in Scotland, the likelihood is that, unless changes are made to areas such as eligibility criteria, demand for these services will increase costs."

"In 2010/11, the combined cost of free personal and nursing care, free prescriptions, free eye tests and the national concessionary travel scheme cost around £870 million and the costs are rising. The Scottish Government has yet to take forward the Independent Budget Review Panel's recommendation that all universal services should be reviewed to see if they should be maintained in their current form, focusing on changes in eligibility criteria, the introduction of charges and to ensure that those who need these services most are not disadvantaged. Our report on the national concessionary travel scheme stated that the scheme cost £199 million in 2009/10 and that costs are expected to rise. We projected that, based on current levels of concessionary journeys and a range of fare increases, the uncapped costs of the scheme could reach between £216 million and £537 million by 2025."

**Scottish Parliament Finance Committee
Roundtable on “Can Universalism Survive?”
25 January 2012
Information from NESTA**

About NESTA

NESTA is the UK’s foremost independent expert on how innovation can solve some of the country’s major economic and social challenges. Its work is enabled by an endowment, funded by the National Lottery, and operates at no cost to the government or taxpayer. NESTA is a world leader in its field and carries out its work through a blend of experimental programmes, analytical research and investment in early-stage companies.

NESTA’s Public Services Innovation Lab works across a range of service areas to design, develop and test new approaches to tackling the UK’s most pressing social challenges and transform our public services. In particular, our research and practical work has explored the potential for interventions that achieve better prevention and early intervention such as in health, social care or early years’ services.

In Scotland, our work has included both policy work and practical programmes in the field of encouraging innovation in public services and we have recently commissioned a further piece of work examining the prospective role of social ventures in that transformation.

Public services face a crisis of the need for immediate savings but also long-term rising demands and expectations

In 2011-12, the Scottish Government budget was reduced by £1.3 billion, with a 22.9 per cent cash reduction to the capital budget. Under the plans that the UK Government announced in its October 2010 Spending Review, between 2010-11 and 2014-15, resource budgets are expected to fall by 9.2 per cent and capital budgets by 36.7 per cent.

The impact on public services of these rapidly shrinking resources is compounded by changing public demand. Even before the financial crisis, professionals were struggling to cope with the increased demand of an ageing population and complex social and behavioural issues like obesity, binge drinking, chronic disease and mental wellbeing. Public services were not set up to deal with these issues. The NHS, for example, still invests the majority of its resources in acute care rather than preventative approaches despite the majority of demand coming from managing long-term conditions.

As public demand is projected to rise as a result of prevalent social challenges, further cuts to essentially unchanged services could cause a deeper crisis in the future. Scotland’s population is both growing and ageing. By 2031, the number of people over 50 in Scotland is projected to rise by 28 per cent, with the number of people over 75 increasing by 75 per cent. This is a sharper increase than in other parts of the UK.¹

The health care costs of alcohol abuse were estimated in 2007 to comprise 7.5 per cent of total healthcare costs in Scotland – an average of £268.8 million. The costs of crime resulting from alcohol abuse were as

¹ Scottish Government (2007) All Our Futures: Planning for Scotland with an Ageing Population. Edinburgh: Scottish Government

much as 20.4 per cent of Scotland's total crime spending, with the majority resulting from costs as a consequence of crime.²

Obesity in Scotland is rising rapidly and currently Scotland has one of the highest levels of obesity in OECD countries – only the USA and Mexico have higher levels. Projections indicate that by 2030 more than 40 per cent of Scotland's population could be obese, an increase of 50 per cent from 2008. The social and economic costs of this trend are high. Obesity costs represent 2 per cent of the total NHS Scotland budget, close to £175 million, and the total cost to society has been estimated at £457 million.³

Barriers to better services

Given the shape of the public sector in Scotland, and cultural issues around how services are designed, delivered and managed there are some common barriers that can be identified including:

- **Collaboration and partnership working** – making the required decisions to change a service is often prohibited by organisational boundaries or siloed budgets. Making collaboration work requires that incentives are aligned and that organisations work towards shared outcomes;
- **Effective Commissioning** – often the benefits and savings from changes in service take time to accrue which makes developing a business case within one or two year budget planning cycles difficult. Though methods for evidencing the costs and benefits of prevention are becoming more sophisticated, operational processes can remain a barrier;
- **Financing in the short term** – a radical shift in the way a service is delivered can require decommissioning of institutions or changes in service down-stream. This is particularly the case in a constrained financial context, and can prompt strong political or workforce opposition;
- **Skills, culture of provider and commissioning organisations** – performance management processes can affect flexibility and incentives which can work against providing an effective services.

Of these barriers, collaboration across or “disregarding” the boundaries of public services is notoriously challenging and there have been a number of high profile initiatives that have struggled to demonstrate real impact. However, partnership arrangements such as Community Planning Partnerships, Single Outcome Agreements and the recent announcement of the creation of new Health and Social Care Partnerships offer a constructive environment for better collaboration, if mechanisms can also enable financial and performance incentives aligned with duties to report on shared outcomes.

Radical innovation makes services most effective, therefore most efficient

The most efficient services are the most effective services, the ones which meet people's needs and resolve problems. Only by transforming services so that they better meet the needs of their users can we unlock the level of savings necessary and continue to improve outcomes.

For example, the Make it Work pilot scheme in Sunderland City Council brought together a number of specialist community organisations covering mental health, drug rehabilitation and carers in a major innovation effort to tackle the city's rising level of worklessness and demand for public services. Over a period of three months, service designers “Live|Work” spent time with individuals not in work to understand real, not perceived, barriers to worklessness and design practical solutions.

² Beale, S., Sanderson, D., Kruger, J., Glanville, J., Duffy, S. (2007) The Societal Cost of Alcohol Misuse in Scotland 2007. Edinburgh: Scottish Government

³ Scottish Government (2010) Preventing Overweight and Obesity in Scotland: a route-map towards healthy weight. Edinburgh: Scottish Government

The Make it Work scheme now supports more than 1,000 people, with 275 finding work. The total cost of running the programme was £180,000. An economist for the Council has estimated overall cost avoidance for the Council of £435,000 through participants entering sustained work. This signals an initial saving of approximately £255,000 with considerably promising long-term saving.

Developing new types of services that are fundamentally more efficient because they are much more effective necessarily depends on innovation. Rather than being opposites, the need to save money on the scale required sharpens the need for radical change and reform.

The most important question for policymakers is not whether to make savings, but how. In doing so, NESTA would argue that the Scottish Government should ensure cuts and efficiencies anticipate the services Scotland wants to have in the future and looks to save money in a way that stimulates and supports transformation.

Public services will be more efficient if they are better at meeting public needs

NESTA's practical experience and research knowledge has shown that the best services in the future will be those based around people's needs and success in meeting them.⁴

Public services need to engage citizens more actively in their design and delivery. Southwark Circle is a social enterprise operating in South London which is developing a new model of service to improve the quality of life and wellbeing for older people. It was co-designed with the help of over 250 older people and their families and employs local Neighbourhood Helpers to deliver practical help to its members. Southwark Circle builds on the social networks that exist within a community to support older people and provides a mechanism through which they can respond to each others' needs and interests.

In Scotland, the Glasgow Homelessness Network has worked in partnership with Glasgow City Council during the Hostel Closure and Reprovisioning programme to ensure that the views of hostel residents directly informed the closure process. This work formed the basis of the Scottish Government funded Scottish Homelessness Involvement and Empowerment Network and the local Shared Solutions workshop, held across Glasgow to directly involve people affected by homelessness in the planning and delivery of local services.⁵

Services need to be embedded in communities. Connected Care is a toolkit for community-led commissioning of integrated, bespoke services. By focusing on the individual's experience of services, it makes services easier to use and more effective. By integrating health, housing and social care services – and intervening earlier – it achieves better results at lower cost.

Services should also be linked through better use of data, particularly if they can incorporate cost-effective online tools. Patient Opinion is a web platform that allows patient feedback and experience to be put to better use in improving services. It ensures comments and online postings are directed to the right person within the Health Service – in a hospital, PCT or organisation. Unlike time-intensive and expensive consultation sessions, sharing feedback and experience online can offer a signpost to someone to how to improve the service.⁶

Public services need to change their approach to innovation to develop better, lower cost services

Achieving this kind of transformation demands a new approach not just to services but to the development of services. It relies on a much more distributed innovation effort and capability to develop new and better

⁴ See for example 2020 Public Services Trust (2010) Beyond Beverage: future of public services. London: RSA

⁵ <http://www.ghn.org.uk/>

⁶ For further discussion see Bunt, L., and Harris, M. (2009) The Human Factor: how transforming healthcare to involve the public can save money and save lives. London: NESTA

models that are better suited to public need. In other words, making a shift from service dominated public services to a powerful public demands a corresponding shift in responsibility for innovation and reform.

Success then depends on central government's ability to 'let go' of the reins of innovation and liberate local innovators to develop new systems that will serve their communities in different – and better – ways, for much lower cost. Making services much more responsive to public need means that those who understand these needs best – frontline staff, local communities and the service users themselves – need to be involved in the redesign and development of services. This means starting with communities and what matters most to them.

In 2007, NESTA launched an open innovation challenge for communities groups to tackle climate change. The Big Green Challenge – which ran until 2010 – invited community groups to propose innovative ways to reduce carbon emissions in their areas to compete for a £1 million challenge prize. Over 350 ideas were put forward, of which 100 were selected and further developed into detailed plans. Ten finalists were selected on the basis of these plans and put their ideas into practice during the final year of the challenge.

The Big Green Challenge has been effective at reducing emissions, the ideas put forward were diverse and unexpected, and was a relatively low-cost way to support widespread localism. NESTA's report *Mass Localism* draws on the practical lessons of the Big Green Challenge in more detail and explores their implications for other areas of public policy.⁷

Age Unlimited Scotland – NESTA has worked with 27 projects over two years, supporting people in their 50s and 60s in Scotland through a new innovation process to design, develop and deliver their good ideas for community ventures, across Scotland, with 16 projects being awarded micro finance investment average £5,000. The social challenge 'competition' acted as an emotive trigger – reaching, stimulating and supporting people to take action. NESTA also proved that the project enhanced participant's sense of purpose, self-belief, instilled confidence and determination – encouraging enterprising behaviours and active ageing.

Stimulating Innovation and Supporting Transformation

In comparison to the private sector, innovation capacity and conditions in public services are still too weak to make significant savings and ensure transformation. Innovations are often underdeveloped, business models and evidence base are weak especially on saving money at scale.

It is often difficult to develop and implement new approaches within existing public services, where organisational structure and culture can stand in the way. In particular, radical innovation and change is difficult to achieve due to internal resistance because they are disruptive to the existing system. NESTA's own practical work and investments in healthcare have provided copious evidence that many innovations struggle for support or fail to get adopted across the system.

NESTA's experience supports the suggestion that one of the biggest challenges in radically transforming services is how to disinvest resources away from one service to invest in another.⁸ This is particularly the case in a context of reduced public spending. Developing a model for sustainable disinvestment and reinvestment ought to be a priority for the Scottish Government.

Social Impact Bonds are an example of one such mechanism currently being trialled in Peterborough to prevent re-offending and reduce rates of incarceration. Social Impact Bonds are contracts with the public

⁷ See Bunt, L., and Harris, M. (2010) *Mass Localism: a way to help small communities solve big social challenges*. London: NESTA

⁸ Finance Committee Inquiry into Preventative Spending, submission from COSLA

<http://www.scottish.parliament.uk/s3/committees/finance/inquiries/preventative/PS-COSLA.pdf>

sector in which it commits to paying for improved social outcomes. They draw in investment from socially-minded private and public investors and improved outcomes deliver a return. They are an innovative financial instrument designed to increase funding for prevention.⁹

Social Impact Bonds have leveraged investment of up £5 million from 17 investors to work with 3,000 male short-term sentence prisoners leaving HMP Peterborough to develop a new range of services that prevent reoffending. Though still at a relatively early stage, evaluation of the implementation of Social Impact Bonds by RAND and the Ministry of Justice have highlighted a range of benefits for investors and service providers, such as in managing risk, aligning incentives and funding under-provided services.¹⁰

Recommendations:

- Create demand by not including efficiencies and cuts in budget assumptions. Rather than starting with limited incremental efficiencies, policymakers should seek to make larger savings over a longer-time period to prompt radical efficiency solutions. Rather than starting with cuts and savings, or a debate about universal or means-tested services, government should start with asking how services can be radically better.
- Re-orientate accountability mechanisms to make them prompts and triggers for radical efficiency rather than reinforcing the status quo. Current accountability mechanisms – targets, commissioning, guarantees – can in effect lock-in inefficiency.
- Cut incremental innovation, but invest in more ‘good waste’ in experimentation and development. In the NHS in Scotland for example, the last year of guaranteed investment should invest in more patient-centred, preventative approaches that will make services more effective in the future.
- Create and encourage new vehicles for innovation such as co-designing new approaches that put users at the centre of the service and allow the public, communities and frontline workers to lead the transformation process.
- Protect and extend the projects that are implementing innovative new approaches and proving their effectiveness. Innovative types of services and approaches that represent the future are likely to be the most vulnerable to cuts when approached in a traditional way as they may appear marginal, too local or still developing an evidence base.
- Draw on open and user innovation, involving frontline staff, communities and service users. Advance the agendas of community ownership of services exemplified to give communities and staff a greater stake in their services and more control over decisions. Government should also establish more open, iterative innovation processes at a local level so that frontline staff and service users are more directly involved.

⁹ For more information on Social Impact Bonds see Social Finance Ltd (2009) Social Impact Bonds: re-thinking finance for social outcomes. London: Social Finance Ltd <http://www.socialfinance.org.uk/work/sibs>

¹⁰ Disley, E., Rubin, J., Scraggs, E., Burrowes, N., Culley, D. (2011), Lessons from the planning and early implementation of the Social Impact Bond at HMP Peterborough. London: Ministry of Justice and RAND



**Scottish Parliament Finance Committee
Fiscal Sustainability – Universal Services
Summary of PwC Citizens’ Jury**

In April 2011, PwC brought together 24 men and women – a representative cross section of people from across Scotland – to participate in a Citizens’ Jury on the future of Public Services in Scotland. Our aim was twofold – to generate insight into citizens’ views on priorities for public services in Scotland and how they should be delivered and to provide the Commission on the Future of Public Services in Scotland, The Christie Commission, which was in the later stages of its evidence gathering process, direct access to the views of a broad cross-section of the public, rather than those specifically motivated to participate in the evidence gathering process.

The two day Citizens’ Jury process took an in-depth look at a range of issues and provided a wider perspective to the Christie Commission on the views of ordinary people from across Scotland. It culminated in a presentation of the Jury’s views to the Commission and the opportunity for representatives of the Commission to question the Jury.

The Jury was developed as a robust method of deliberative research, managed by Britain Thinks, a leading public opinion research consultancy in partnership with PwC. Over two days, experts from organisations such as NHS 24, The Scottish Government and Scottish Futures Trust, as well as the Auditor General for Scotland and specialists from PwC, ensured the jurors had the information necessary to make well-informed, well-considered recommendations.

The Jury was invited to arrive at a view on their underpinning values for the delivery of public services and then to consider their priorities for Scottish public services. The jury had a clear vision for public services in Scotland – services that are fair, accessible, disciplined, entrepreneurial and honest, and that encourage personal responsibility. With these values and the right information, the jury was able to prioritise between “essential”, “ideal” and “nice to have” services.

Essential services were health, education, housing, and emergency services.

Ideal were affordable sports and leisure, free library services, high quality roads and transport. Nice to have included free prescriptions, free concessionary travel, free universities and free leisure facilities.

At the conclusion of the two days, the Jury presented their recommendations to representatives from the Christie Commission. The key messages, summarised on page 6 of the report, were as follows:

1. There is a demand for good quality unbiased information
2. Fairness and “personal responsibility” are key priorities
3. People are more willing, once informed, to accept that not all apparent priorities can be met
4. There is a real appetite for change that is bold and long term
5. Citizens are willing to change their views in response to clear, relevant information

As people became better informed over the two days, they became more accepting of change and were very focused on the outcomes they receive from public services rather than how they are delivered or who delivers them. They were also prepared to recognise the sacrifices that might need to be made in lower priorities to preserve the level of priority services.

Consequently, some universal services, particularly healthcare and education, were the Jury's highest priorities. They were willing to accept an increase in charges in order to protect the highest priority frontline services, but would first want to move money from lower priorities or step back from some universal support - even to scrap free prescriptions and concessionary bus travel and accept university fees. They also expressed interest through discussion in the behavioural consequences of certain free services, concluding, for example that free prescriptions may inflate demand beyond need.

The Jury's views on a wide range of questions were polled at the start and at the end of the two days. Their views changed quite markedly in a number of areas:-

- 75% agreed we should be willing to pay more taxes or charges to safeguard public services (compared to 37% at the start of the jury)
- 80% believed that those who could pay, should pay for prescriptions (compared to 46% at the start of the jury)
- 29 % believed council tax should be frozen for a further period (compared to 58% at the start of the jury)

The importance of providing robust information and hard facts became apparent when the Jury was asked to gauge the extent of their understanding of how Scotland's public services budget is spent. At the start of the deliberations only 16% felt well informed compared to 63% at the end of the session. In addition, only 29% understood the level of spending cuts required, with this figure subsequently shifting to 75%.

The jury showed a real appetite for change based on long-term strategic planning for long term outcomes rather than centred on political cycles – and crucially they wanted the public to be involved in a meaningful way.

The consensus view was for government and public sector leaders to 'think in new ways rather than tinkering around the edges of the existing system'. Great emphasis was placed on 'personal responsibility and changing people's behaviours' to get them to make the right choices in order to reduce the culture of state reliance and create a fairer society.

On the topic of ring-fencing, the citizens' opinions also shifted significantly following the expert briefings and panel discussions. At the end of the jury, 75% believed strongly that no areas of public spending should be ring-fenced – a shift of 25% over the two days. In addition:

- 25% thought it was very important to keep free university education for all Scottish students (pre- 50%)
- 17% thought that concessionary bus travel for over 60's was very important (pre- 33%)

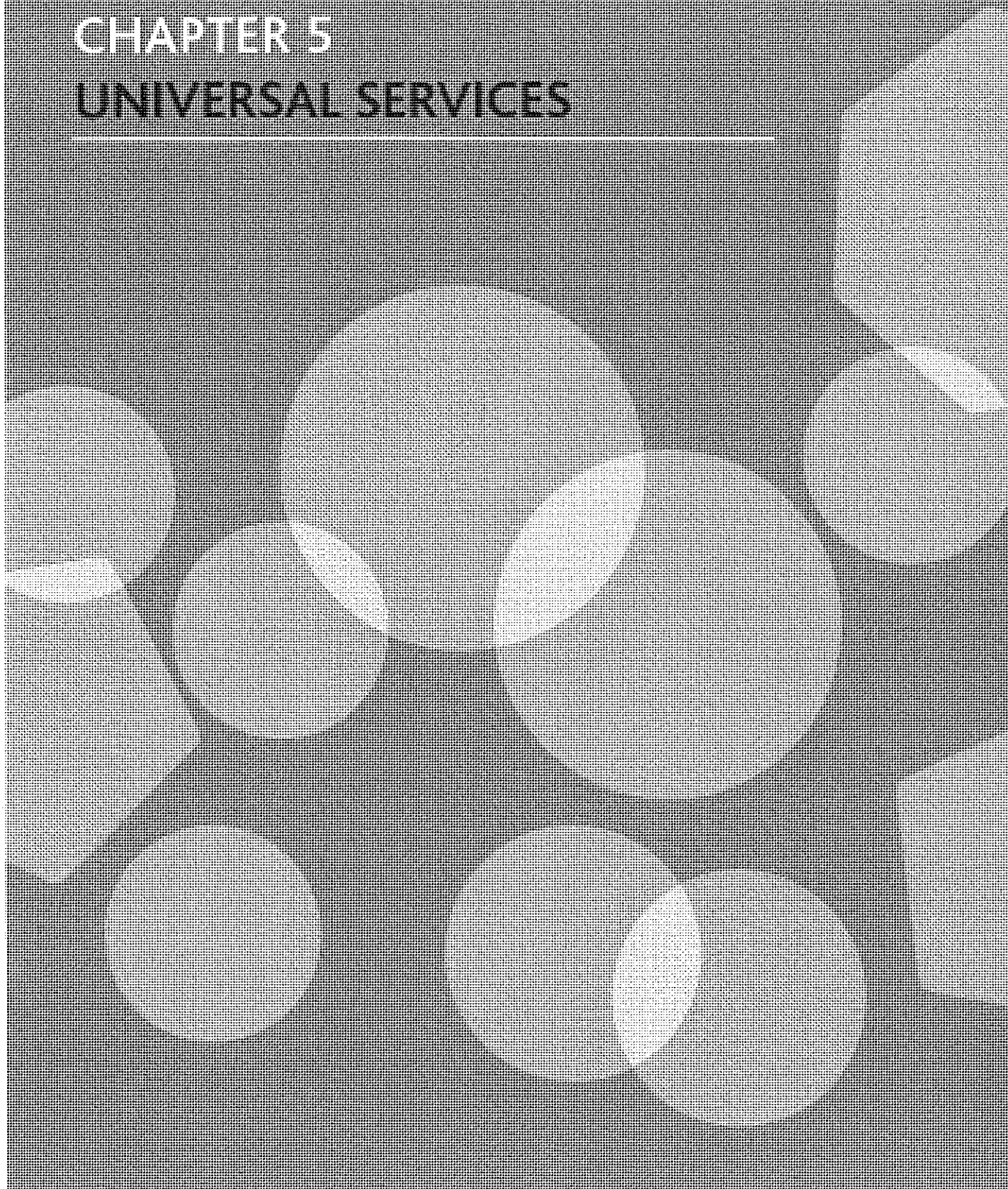
When asked if it was important for local authorities to work together to deliver services more cost-effectively on a shared basis, half the jury believed this was important – a viewpoint which changed significantly to 20 out of 24 after the expert briefings.

A key lesson from the jury deliberations is that when clear and unbiased information is provided, people are more willing to take shared ownership of the issue, accept decisions that would impact them personally, and give Government the 'permission' to make the hard choices necessary.

The Citizens' Jury's findings can be found in a report '*A time for change?*', which can be downloaded from the PwC website: (<http://www.pwc.co.uk/scotland/hottopics/citizens-jury.html>)

CHAPTER 5

UNIVERSAL SERVICES



INTRODUCTION

"The balance between universal provision and means-tested benefits in different countries reflects different value structures and political realities. However, during the last decade, when resources were growing rapidly, successive Scottish governments have not needed to focus attention on this question. The reductions in the budget that are in train imply that avoiding the question is no longer tenable."

Meeting the Challenge of Budget Cuts in Scotland: Can Universalism Survive?
Paper for Scottish Parliament Finance Committee, Professor David Bell (April 2010)¹

Changes since devolution

5.1 The Scottish Parliament has expanded the provision of free or subsidised public services on a near universal basis since Devolution over a decade ago. Such universal services were introduced in what was an increasing and buoyant public spending context. This has effectively shifted funding responsibility from the individual to the state. Demographic trends are already increasing the cost of such services – and are expected to continue to drive up costs in future.

5.2 The Panel believes that the continuing provision of a range of universal services on the same basis as at present is unlikely to be affordable in the face of the projected financial challenges. Alternative approaches should, therefore, be considered as a matter of urgency.

"The estimated cost of free personal nursing care, prescriptions, eye tests and concessionary travel is almost £900 million in 2010-11. As the public become more accustomed to these services and Scotland's demographics change the demand and cost of these services will continue to increase. Future costs are difficult to predict, which raises questions about their long term affordability."

Audit Scotland, submission to the Independent Budget Review

BACKGROUND

Cost drivers

5.3 The Panel heard from a number of stakeholders that many universal services appear to have been introduced without sufficiently rigorous business case development or a full assessment of rising future demand and long-term affordability. Demographics, consumer expectations and other drivers continue to stimulate demand and, as a consequence, are forcing up the projected cost of many universal services.

¹ www.scottish.parliament.uk/s3/committees/finance/inquiries/budget/documents/BSP_adviser1.pdf

**Equity
and
consistency**

5.4 The introduction of free universal services has resulted in many beneficiaries receiving free or subsidised services which they might otherwise have been able and, indeed, willing to fund on their own behalf. There is also some inconsistency in the provision of universal services and differences between levels of service in different local authority areas.

5.5 The Scottish Parliament Finance Committee has also identified the provision of universal services as a key issue for the next Spending Review period and beyond:²

"The retention of spending on universal benefits means that there will be less flexibility in seeking cuts in the rest of the budget. Given ... demographic trends, the retention of some universal provision, particularly free personal care, will also have longer-term financial implications."

Scottish Parliament Finance Committee Report - Budget Strategy Phase (June 2010)

5.6 Similarly, a recent report by Professor Charlie Jeffery of Edinburgh University considered the provision of universal services for older people, particularly free personal and nursing care (FPNC) and concessionary travel, and raised some key questions that are more widely pertinent and relevant to the Panel's deliberations:³

"Is it right that all people over 60 – including wealthy ones – get concessionary bus travel when people who may need transport services more (for example, frail older people, people in rural areas) have to pay for demand responsive transport? Is it right that all income groups should have access on the same terms to FPNC? If it is legitimate to target policies in some areas, like fuel poverty, onto the most disadvantaged, why is it not in other areas?"

Older People, Public Policy and the Impact of Devolution in Scotland,
Report for Age Scotland by Professor Charlie Jeffery, Edinburgh University (June 2010)

5.7 Professor David Bell of the University of Stirling, standing budget adviser to the Scottish Parliament Finance Committee, recently set out the principal arguments for and against universalism and means testing:

² www.scottish.parliament.uk/s3/committees/finance/reports-10/fir10-04-vol1.htm

³ www.ageconcernandhelptheagedscotland.org.uk/documents/893

Arguments for and against universalism and means testing

"The main arguments for means testing and against universalism are:

1. Resources are targeted where they are most needed, leading to lower overall costs compared with universal benefits. Resources are released to other government priorities or taxes can be reduced.
2. Services are not offered to those who could afford and would be willing to pay. Providing a service to those that are willing to pay is a 100% deadweight loss to the taxpayer.
3. Provision of universal benefits can interfere with market provision. Markets may not be efficient where the state is the main purchaser.
4. Provision of free services can lead to inflated demand. This is a variant of the moral hazard problem.
5. Universal benefits are difficult to rescind because they are often seen as entitlements whose removal can be legally contested. Means-tested benefits, on the other hand, are more easily varied. Thus, for example, it may be relatively easy to vary the willingness-to-work conditions associated with unemployment insurance. But removing the right to free health care would be well-nigh impossible politically.
6. Because clients are directly contributing towards some share of the costs, they have a greater incentive to improve the quality of service or make it more efficient.

"The main arguments for universalism and against means testing are:

1. Korpi and Palme (1998, p. 663)⁴ have argued that there is a 'paradox of redistribution' whereby 'the more we target benefits to the poor ... the less likely we are to reduce poverty and inequality.' Highly targeted programmes have a limited support base. They tend to result in conflict between those above and below the means test limit. Such programs therefore have limited appeal to the majority of voters that are above the means-test limit. Universal programs have a much broader political support. Means testing may undermine public support for those receiving benefits.
2. Along similar lines, universal policies may increase the preference for redistribution by generating a more cohesive group identity. Thus, for example, Scandinavian countries have highly redistributive tax systems that are based around universal rather than means-tested benefits.
3. Means testing causes stigmatisation. It inevitably focuses arguments around who is 'in' and who is 'out' and whether those that are 'in' are 'deserving'.

4 *The Paradox of Redistribution and Strategies of Equality: Welfare State Institutions, Inequality and Poverty in the Western Countries*, W Korpi and J Palme (1998) www.fcs.edu.uy/enz/licenciaturas/cpolitica/taller%20democracia%20y%20desarrollo/Unidad%203/Korpi%20and%20Palme%201998.pdf

4. Many people, particularly the elderly, do not take up means tested benefits even when eligible. But as Hancock et al (2005)⁵ argue, take-up is greater among those with greater entitlement.
5. Universalism is less costly to administer since the process of means-testing itself uses significant amounts of resource. Often means tests are carried out by those delivering the service, e.g. medical professionals, which can create conflicts of interest.
6. Means-testing discourages savings because individuals have an interest in letting their assets fall below the means-test limit, knowing that they can then receive services free. But universal provision also discourages saving because it guarantees a certain level of service, irrespective of the level of saving."

Meeting the Challenge of Budget Cuts in Scotland: Can Universalism Survive?
Professor David Bell, Paper for Scottish Parliament Finance Committee (April 2010)

5.8 The Panel also noted the concerns raised by some representative groups about the introduction of charging for services and increased levels of means testing:

"STUC has given strong support to ... policies [such as Free Personal Care, Tuition Fees and Prescription Charges] and more generally supports universal provision backed by progressive taxation as the most efficient and sustainable way to maintain strong services and an adequate safety net.

"STUC would be particularly concerned if the mechanism for moving towards more targeting of services were to be through charging for services (particularly at local government level) rather than using devolved taxation mechanisms."

STUC, submission to the Independent Budget Review

Options for change

5.9 Limiting or targeting free entitlement, tightening of eligibility criteria, introducing or increasing charges (or reducing subsidies) and introducing means testing all appear to have the potential to reduce public costs. The choice of these or any other similar options should be based on the relative importance of activities and robust evidence-based assessments of the effectiveness of services. The approach should aim to protect the most vulnerable in our society and take full account of the direct and indirect consequences of any changes.

5 *What should be the role of means-testing in state pensions?* Seminar 5 in programme *Shaping a stable pensions solution*, R Hancock, S Pudney, H Sutherland, G Barker and M Hernandez (2005), Nuffield Foundation and University of Essex
www.pensionspolicyinstitute.org.uk/uploadeddocuments/PPI_Nuffield_seminar_5_main_paper_Nov05.pdf

Focus

"There is a creeping acceptance that universal provision is the norm but carrying on with universal provision is as much a policy choice as not doing so. In considering policies the starting point must be to ask whether the service should be universal or targeted."

COSLA, submission to the Independent Budget Review

5.10 The Panel believes that all citizens should have affordable access to public services provided in an equitable way. Universal free services have been developed to meet the needs of large groups rather than focused on those individuals who need them the most. Quality public services should be dynamic and flexible to take account of the changing nature of society, demographics, availability of funding and of the citizen's expectations about rights to essential services, as well as changes and improvements in service design and delivery.

5.11 That does not mean that a 'one-size-fits-all' approach should be adopted in providing free access to public services. There is scope to adopt a more focused approach, prioritising services to individuals' particular circumstances and needs while also reducing public costs.

**Eligibility
and
means
testing**

5.12 Reviewing eligibility criteria should be aimed at achieving closer alignment between provision and need. This has the potential to ensure that those who have greatest need benefit most from public services. This might include amending age thresholds at which citizens can benefit from free or subsidised services, or it might also include applying limits or caps on the level of benefits available.

5.13 Means testing is another way of assessing the eligibility of an individual to receive a particular service at reduced or zero cost. It can be helpful in identifying those who are least likely to be able to afford to pay for a service. Ensuring services are focused on the most needy can reduce the burden on the public purse and increase the effectiveness of spending. However, the Panel recognises that means testing has a number of potential disadvantages, many of which have been described by Professor David Bell in the paper quoted above. These include impact on self-esteem and responsibility, which can reduce the level of take-up of services by those who would most benefit from them, and an increase in the level of administration needed to support means testing.

5.14 The Panel considers that every effort should be made to avoid implementing additional, bureaucratic administrative processes. It may be possible to minimise additional costs and bureaucracy by adopting existing systems or identifiers which already involve an assessment of suitable eligibility criteria. For example, the existing benefits system might be used to help confirm those who have greatest need of other public services or support. This approach is sometimes referred to as 'passporting'.

User charging

"Questions should be raised as to why it is proper to charge for services which enable a disabled adult to live an independent life, participating in the lives of their families and communities, but improper to charge for admission to art galleries and museums; and why it is proper to provide free nation-wide bus travel for those over sixty, irrespective of income, but improper to provide subsidised taxi fares."

Independent Living in Scotland Project, Scottish Disability Equality Forum and Inclusion Scotland, joint submission to the Independent Budget Review

5.15 Introducing charging (or reducing subsidy) for some universal services currently provided free or at low cost could ensure that those citizens who can afford to do so contribute to costs. Charging could also free up valuable public resources and might help to limit demand. The introduction of charges – such as charges for missed appointments or congestion charging – has the potential to drive positive behavioural changes. Charging can also drive up expectations of service quality. It appears that, under some circumstances, the public may prefer to pay for specific services rather than see increases in the rate of general taxation.

5.16 The (re)introduction of charging could be challenging to pursue, as people tend to become accustomed to services being provided free at the point of delivery and may come to see them as an entitlement. Charging could also be seen as running against the general direction of policy established over the past decade. The introduction of service charging will not be appropriate for all users or for all services.

5.17 The Panel, however, believes that public sector bodies should be encouraged and have the flexibility to examine the potential for additional income generation by reviewing the level of existing local charges within their scope or by introducing new charges. The Panel believes that any introduction of charging must be affordable, equitable and transparent and should ensure that, as far as possible, the most vulnerable in society are not placed at a disadvantage. In this time of tight financial constraint, the Panel shares the Scottish Parliament Finance Committee's recent conclusion that public debate on this issue should be opened up.

5.18 The Panel considers that work to review the approach to providing universal services and the blocks of spend allocated to these services is now required as a matter of urgency. This work should consider the long-term issues such as changing demographics, affordability, sustainability and the services where scope for reform is possible. It should also consider the extent to which the provision of universal services contributes to national outcomes.

The Panel suggests that the Scottish Government and Parliament should consider undertaking immediate work to review whether all free or subsidised universal services should be retained in their current form. This work should cover issues such as changes in eligibility and the introduction of charges and ensure that those in greatest need are not disadvantaged.

In addition, the Panel suggests that the Scottish Government should encourage all public sector bodies to examine the potential for additional income generation by reviewing the level of charges within their scope or by introducing new charges.

**Universal
services for
further
consideration**

5.19 The Panel recognises that a wide range of universal, or near-universal, services are currently supported by public expenditure in Scotland. In the limited time available, the Panel was not able to consider all of these in detail. However, for indicative purposes and to inform the debate, it has focused some attention on six services funded directly or indirectly by the Scottish Government where the evidence suggests possible options for reducing costs:

- concessionary travel;
- free personal and nursing care;
- prescription charges;
- eye examinations;
- free school meals; and
- tuition fees.

CONCESSIONARY TRAVEL

"Studies have shown that lower income groups gain greater improvement in their quality of life from the concession, and use it frequently. By contrast higher income 60+ groups claim that the concession has virtually no effect on their quality of life. But this does not mean that lower income groups are the main beneficiaries of extending the concession in 2006: 'the larger effect has been one of stimulating pass take-up and thus bus use among wealthier pensioners, albeit at a lower number of trips per person than their poorer counterparts'. Similar to FPNC [free personal and nursing care], the Concessionary Travel Scheme might be criticised as extending a subsidy to those affluent enough to pay for services themselves."

Older People, Public Policy and the Impact of Devolution in Scotland,
Report for Age Scotland by Professor Charlie Jeffery, Edinburgh University (June 2010)⁶

6 www.ageconcernandhelptheagedscotland.org.uk/documents/893

Experience across the UK

5.20 The Scotland-Wide Free Bus Travel Scheme for Older and Disabled People was introduced in 2006. It provides unrestricted free national bus travel for eligible passengers based on agreed levels of reimbursed payment to bus operators. Eligibility for concessionary bus travel is based upon age (60 or over), residence in Scotland and disability status.

5.21 In England, concessionary bus travel is restricted to off-peak hours between 9.30am and 11pm on weekdays and all day at weekends and on bank holidays for passengers currently aged 60 or over. However, a package of reforms to concessionary bus travel in England was announced in 2009, including a change to the age of eligibility for the concessionary bus pass in line with changes to the state pension age with effect from April 2010. By 2020, the age of eligibility for concessionary travel in England will increase to 65.

5.22 Wales operates a similar all day scheme to the Scottish Scheme for passengers aged 60 or over and disabled passengers of any age. The scheme in Wales also provides free travel on local buses by companions to disabled persons.

5.23 For schemes in both England and Wales, the criteria are enhanced by many of the local authorities.

5.24 The Northern Ireland scheme provides concessionary travel by bus and train across Northern Ireland for all residents aged 60 and over, registered blind or a War Disablement pensioner. An all-Ireland free travel scheme was introduced in April 2007 for senior citizens in Northern Ireland aged 65 and over and for Republic of Ireland senior citizens aged 66 and over.

5.25 In Scotland, an agreed cap limits the future costs of the concessionary scheme to £180 million and £187 million in 2011-12 and 2012-13 respectively. Beyond this, if there is no cap and if bus fare levels were to increase by 8 per cent per annum, costs are estimated to rise to around £261 million in 2013-14 and to around £286 million in 2014-15.

Review

5.26 The Scottish Government's 2009 *Review of the Scotland-Wide Free Bus Travel Scheme for Older and Disabled People*⁷ confirmed that there were just over 1.1 million valid national entitlement cards (representing one in five of the population) and that the scheme was running at an average of 13.2 million journeys each month in 2008-09. There was evidence that, as a result of the scheme, some passengers had travelled by bus at the expense of travel by car. However, there was insufficient evidence to clarify the extent to which the scheme had contributed directly to social inclusion.

7 www.scotland.gov.uk/Publications/2009/05/19093131/0

5.27 The Panel recognises the progress which has been made by the Scottish Government in implementing the Review's recommendations to control costs through the renegotiation of the percentage of reimbursement to bus operators and the capping of the scheme costs. However, the impact of this is likely to be relatively marginal in relation to the total costs of the scheme. Projected costs reflect significant increases in the number of people over 60 and eligible for the scheme.

5.28 The Panel understands that approximately one in five of those eligible for the scheme as a result of their age are in employment. Some of these people may also be both able and willing to fund their own bus travel.⁸ The proportion of older people who will be working longer is likely to continue growing in future. In light of this, the 2009 Review concluded that:

"There may be a case in the future for examining the value of money of concessionary travel for those passengers over the age of 60 in full time employment and earning a salary (with or without a pension supplement) i.e. where issues of social exclusion and mobility are not an obvious priority."

Review of the Scotland-Wide Free Bus Travel Scheme for Older and Disabled People, Scottish Government (May 2009)⁹

Options to reduce costs

5.29 The Panel was attracted to three main options to amend eligibility so as to contain future costs:

- **Option 1:** raise the age of entitlement from 60 to 65 and subsequently in line with retirement age;
- **Option 2:** remove eligibility for those in full-time employment; and
- **Option 3:** restrict concessionary travel to non-peak periods.

5.30 Implementing any of these options from 2011-12 would require a Statutory Instrument to be laid in good time before the end of the current financial year.

5.31 The estimated savings from each option are considered in relation to current estimates of projected costs, assuming no change in the current eligibility criteria. The costs of the scheme to the Scottish Government in 2010-11 are capped at £174 million. Net savings in relation to this baseline generated by Option 1 – which is likely to generate the greatest savings – are also shown, for illustrative purposes.

8 The figure of 20 per cent includes both full- and part-time employees as well as the self-employed.

9 *Review of the Scotland-Wide Free Bus Travel Scheme for Older and Disabled People*, paragraph 182.

5.32 It should be borne in mind that the estimated savings described here are based on a range of highly sensitive assumptions and do not take account of all factors. They are, however, intended to provide a reasonable indication of the scale of potential savings, all other things being equal.

Table 5.1

Consolidated, Total Income Projections (in £ million)					
	2010-11	2011-12	2012-13	2013-14	2014-15
Proposed cuts, assuming no change in eligibility criteria	181	187	191	194	194

Source: Scottish Government

Table 5.2

Estimated Potential Savings (in £ million) in Relation to Proposed Future Cuts (as presented in previous table)					
	2010-11	2011-12	2012-13	2013-14	2014-15
Option 1					
Reduction of expenditure from £0 to £0 per year	41	17	14	10	73
Option 2					
Revenue eligibility for those in full-time employment	0	0	23	23	41
Option 3					
Reduction in expenditure from £0 to £0 per year	0	0	11	12	24

Source: Scottish Government

Table 5.3

Proposed Net Costs of Scheme (in £ million) - After Deduction of Estimated Savings of Option 1					
	2010-11	2011-12	2012-13	2013-14	2014-15
Net costs of scheme, after savings assumed from Option 1 only	140	170	177	184	121

Source: Scottish Government

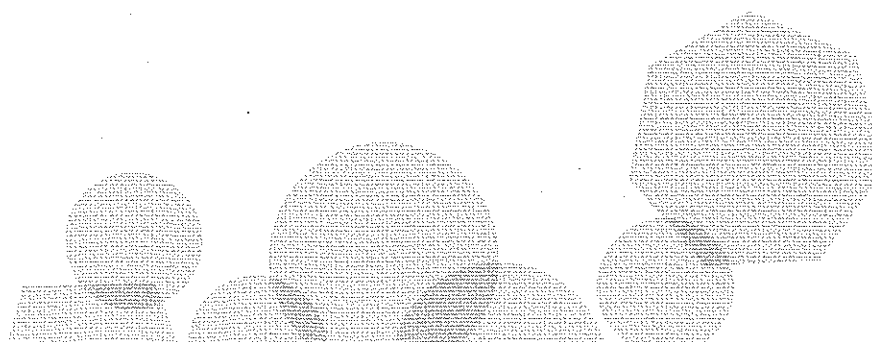


Table 5.4

Estimated Annual Savings from Option 1, 2 and 3 (relative to total baseline cost of Scheme in 2010-11 of £174 million)					
	2010-11	2011-12	2012-13	2013-14	2014-15
Estimated Annual Savings from Option 1	£174m	£174m	£174m	£174m	£174m
Estimated Annual Savings from Option 2	£174m	£174m	£174m	£174m	£174m
Estimated Annual Savings from Option 3	£174m	£174m	£174m	£174m	£174m
Estimated Annual Savings from Option 1, 2 and 3	£174m	£174m	£174m	£174m	£174m

Source: Scottish Government

Notes:

- 1) Data provided by Scottish Government, May 2010.
- 2) Table 5.4 shows the amount by which the projected net cost of scheme, after deducting the estimated savings from Option 1 above, is less (or more) than the total baseline cost for 2010-11 of £174 million.
- 3) Projected costs and savings shown reflect GROS population forecasts and the following assumptions: i) take-up of concessionary travel cards in the 60+ age group continues at the 2008 rate; ii) 5% of concessionary journeys are made between 7 and 9am; iii) 9% of those aged 60+ are in full-time employment; iv) no change in the average number of trips made by all passholders; v) no change in the number of disabled (etc.) pass holders; vi) average fare increases of 8% per year.
- 4) For the purposes of Option 1, it has been assumed that all people aged 60 to 65 would cease to be eligible on 1 April 2011. The table does not show the (much smaller) savings that could be achieved from the more realistic option of gradually increasing the entitlement age in a phased approach.
- 5) Estimated savings in 2011-12 and 2012-13 take into account agreed caps.

5.33 It is important to emphasise that the projected costs of the scheme are expected to rise by 64 per cent by 2014-15, as a consequence of both demographic change and the ending of the current capping arrangement. All three options for savings would have an impact on the rate of growth in net costs, but the general increase in the number of eligible older people would continue to exert upward pressure on the overall costs of the scheme.

5.34 Raising the age of entitlement from 60 to 65 would be likely to generate the greatest savings, but potential savings could be slightly greater if two or more options were combined (although it should be noted that Option 2 is likely to overlap to a very great extent with Option 1). It should be possible to implement one or more of these options to allow savings to be realised from 2011-12 onwards.

5.35 Clearly, there are other options which would control costs, such as the introduction of a charge for any new concessionary bus passes. A one-off charge of £20 for new passholders introduced as they became eligible might raise approximately £0.8 million over the coming Spending Review period to 2014, based on current eligibility and take-up rates, although this would be less if the introduction of a charge reduced the current level of take-up.

5.36 The Panel recognises that implementing any of these options might result in higher car use than otherwise would have been the case. Restricting concessionary travel to non-peak times might be seen as a retrograde step, by restricting travel to periods when bus frequency is reduced. Arguably, such an option might run contrary to the current aims of the scheme. Changing the eligibility criteria in relation to age and employment has the potential to generate much larger savings.

5.37 In addition to these options, there are variations which might be applied, as well as longer term options which have the potential to reduce ongoing costs, such as:

- other changes to the eligibility criteria, for example, by widening the exempt periods to include the afternoon peak or by amending eligibility to the state pension age rather than a specified age (if the state pension age changed, so would eligibility);
- a revised reimbursement rate to bus operators based on latest evidence; and
- storage of travel rights by providing a funded travel card with limited annual expenditure.

5.38 These options should be considered in the context of the scheme's policy objectives. The Panel considers that the Scottish Government should start work to explore such options now and that they should form an element of the negotiations with bus operators when the current agreement ends in 2013.

The Panel suggests that the Scottish Government should consider taking immediate action to review eligibility criteria for the Scotland-Wide Free Bus Travel Scheme for Older and Disabled People, and to continue to work with the bus operators to manage costs in the longer term.

FREE PERSONAL AND NURSING CARE

"Perhaps one of the most significant policy commitments delivered by the Scottish Parliament, but one on which older people demographic growth will have the most impact, is the introduction of Free Personal and Nursing Care. ... Given the demographic profile within the East Renfrewshire area, this has resulted in a disproportionate under-funding for the Council to support the policy. This will be exacerbated by growth in the number of older people within the Council area in the future. Fundamental consideration needs to be given to the sustainability of the Free Personal and Nursing Care policy and the basis of its future delivery."

East Renfrewshire Council, submission to Independent Budget Review

5.39 Free personal and nursing care in Scotland provides a set of universal services for people with care needs which are not subject to means-testing. Free personal care is now a legal entitlement for people aged 65 or over who have been assessed as having personal care needs. Free nursing care is available to people of all ages who are assessed as requiring nursing care services. Those who are liable for their full residential care costs and described as 'self-funders' receive a weekly contribution of £156 towards their personal care and £71 towards their nursing care costs.

5.40 Prior to July 2002, older people in Scotland were charged for personal care services provided in their own home. Many residents in care homes had to fund their care in full from their own income and savings.

**Experience
elsewhere
in the UK**

5.41 Free personal care, as the term is understood in Scotland, has not been introduced in the rest of the UK, although support is provided in other ways. People throughout the UK can apply for Attendance Allowance (over 65) and Disability Living Allowance (under 65) as appropriate, although people in care homes receiving personal care payments in Scotland are no longer entitled to Attendance Allowance.

5.42 In England, all care home residents can receive support from a registered nurse in meeting their care needs. They are also assessed for NHS continuing care, which is entirely free in both England and Scotland. If they are not entitled to this, they should be entitled to a non-means tested NHS nursing care contribution, which is a paid direct to the nursing home and currently amounts to £108.70 per week.

5.43 In Wales, local authorities charge for the accommodation and personal care they arrange in residential care settings and have discretionary powers to recover charges as they consider reasonable from adults receiving non-residential services, including personal care.

5.44 In Northern Ireland, local health trusts pay £100 per week towards fees to cover the cost of the nursing element for those who live in a nursing home and have assessed nursing needs. Some people have the full cost of their continuing health care paid for by their local health trust. Non-residential services, including personal care, are subject to financial assessment.

**Demographic
changes**

5.45 Demographic changes are having a huge impact by driving up the level of demand for free personal and nursing care. In the 10 years to 2016, the population of Scotland aged over 65 is estimated to increase by 21 per cent. Those aged 85 and over – who are likely to have greatest need for care – will increase in number by 38 per cent over the same period.¹⁰ This factor has very significant implications for the projected costs of free personal and nursing care:

¹⁰ www.scotland.gov.uk/Topics/Health/care/reshaping/reshapingcarebooklet

"Lord Sutherland made it clear in his independent review in 2008 that the policy was sustainable at that time for the next five years. However, he also concluded that we need to adapt the policy to address demographic changes in the medium and longer terms, and that changes are necessary to ensure the sustainability of the policy."

Shona Robison MSP, Minister for Public Health and Sport, Debate on Free Personal Care, Scottish Parliament Official Report, 24 June 2010¹¹

5.46 Provision of free personal and nursing care on a universal basis means that a significant number of older people are being supported who would otherwise have sufficient resources or disposable assets to fund their own care. At a time when funding is stretched and priorities should be focused on those with the most intense needs, the Panel considers that a wholly universal approach to providing free support along the lines currently in place appears hard to justify.

5.47 The Scottish Government is currently consulting on the how best to reshape care for older people in the context of demographic and other challenges. It has put forward a number of proposals to improve the way support is provided in future. Some of these proposals have the potential to reduce future care costs, such as encouraging people to do as much for themselves as possible, enabling and supporting more volunteers and community bodies to provide 'contact' care and encouraging healthy lifestyles.

"Following the introduction of free personal care in 2002, there has been a significant shift away from care home provision towards greater provision in clients' own homes. Thus, for each older person receiving personal care in a care home in Scotland at the start of 2009, there were 4.7 individuals receiving personal care at home. When the policy was introduced at the beginning of 2002 there were only 3.4 individuals receiving personal care at home for each care home client receiving personal care. This is a very significant shift in the balance of care."

The Impact of Devolution: Long term care provision in the UK,
Professor David Bell, report for the Joseph Rowntree Foundation (January 2010)¹²

5.48 The Panel recognises the importance of seeking new ways of supporting an increasing cohort of older people. It is also aware of some of the real challenges in modifying or withdrawing free personal and nursing care. However, in light of future demographic and financial challenges, the extent to which personal and nursing care should remain a free universal service is a critical issue which needs to be tackled urgently.

11 www.scottish.parliament.uk/business/officialReports/meetingsParliament/or-10/sor0624-02.htm#Col27679

12 www.jrf.org.uk/sites/files/jrf/impact-of-devolution-long-term-care.pdf

"It is too simple to imagine that removing a popular and landmark policy such as free personal care would achieve major budgetary savings. Indeed, it might have the opposite effect by pushing up the number of people who seek to remain in hospital beds free of charge because they cannot immediately find the money to pay for their care-at-home packages."

Shona Robison MSP, Minister for Public Health and Sport,
Debate on Free Personal Care, Scottish Parliament Official Report, 24 June 2010¹³

5.49 The Panel acknowledges that this is a complex area in which alternative policy options would have to be considered very carefully, taking into account the risk of unintended consequences. The Panel has, however, considered a number of potential options for changing the basis of funding for residential care (in care homes) as well as for care provided in individuals' own homes.

5.50 Pursuing any of these options would represent a significant shift in the balance of responsibility towards the individual, particularly for those best able to pay for their care. Implementation of any of these options would require primary legislation which would result in any changes being introduced in 2012-13 at the earliest.

5.51 The estimated savings described here are based on a range of highly sensitive assumptions and do not take account of all factors. They are, however, intended to provide a reasonable indication of the scale of potential savings, all other things being equal.

Table 5.5

Residential care options

Estimated Annual Savings from Options to be Introduced in 2012-13 (in £ million)					
Option	2010-11	2011-12	2012-13	2013-14	2014-15
Reduce the number of care homes in Scotland	0	15	20	25	30
Reduce the number of care homes in Scotland	0	15	20	25	30
Reduce the number of care homes in Scotland	0	15	20	25	30

Source: Scottish Government

5.52 The savings for residential care shown in Table 5.5 are determined in relation to projected future costs. For comparative purposes only, the equivalent annual savings calculated in relation to baseline costs for the current year (2010-11) would be as follows:

¹³ www.scottish.parliament.uk/business/officialReports/meetingsParliament/or-10/sor0624-02.htm#Col27679

Table 5.6

Residential Care Options: Estimated Annual Savings Compared with 2010-11 Baseline Costs (£ million)	
Reducing free personal care to £100 per week	81
Reducing free personal care to £50 per week	279
Reducing free nursing care to £50 per week	27

Source: Scottish Government

Note: According to information received, savings could only be realised from 2012-13, at the earliest.

5.53 The options illustrated in Table 5.6 relating to residential care have the potential to generate estimated cash terms savings to the public purse of between £81 million and £279 million over three years compared with 2010-11 baseline costs in the last three years of the next Spending Review period (i.e. from 2012-13 at the earliest), depending on the option pursued. Any savings would be subject to the early and successful passage of potentially complex primary legislation in the first year of the new Parliament.

5.54 The scale of any changes in funding for free personal and/or nursing care in care homes should be considered in the context of their impact not only on older people and their families, but also on the sustainability of the care homes sector. As a consequence, it might be considered desirable to phase in any change, which would limit the savings available in the earlier years.

Table 5.7

Care at home
options

Care at Home Options: Estimated Savings Compared with Required Future Costs (£ million)					
	2011-12	2012-13	2013-14	2014-15	2015-16
Reduction in cost of care for personal care	0	110	110	110	110
Reduction in cost of care for personal care (phased)	0	110	110	110	110
Reduction in cost of care for nursing care	0	10	10	10	10
Reduction in cost of care for nursing care (phased)	0	10	10	10	10
Reduction in cost of care for nursing care (phased)	0	10	10	10	10
Reduction in cost of care for nursing care (phased)	0	10	10	10	10
Reduction in cost of care for nursing care (phased)	0	10	10	10	10
Reduction in cost of care for nursing care (phased)	0	10	10	10	10

Source: Scottish Government

5.55 The savings for care at home shown in Table 5.7 are determined in relation to projected future costs. For comparative purposes only, the equivalent annual savings calculated in relation to the baseline costs for the current year (2010-11) would be as follows:

Table 5.8

Cash at home options: estimated annual savings compared with 2010-11 baseline (cash, £ million)	
	2012-13
Flat weekly fee of £7 for all personal care needs	£99
Flat weekly fee of £12 for all personal care needs	£121
Cost to family of care fees	£14
Cost to family of care fees	£1
Total savings over three years	£115

Source: Scottish Government

Note: According to information received, savings could only be realised from 2012-13, at the earliest.

5.56 It is very challenging to estimate the potential savings generated from a range of options for personal care of older people in their own homes. This is a consequence of a number of factors, such as the different charging policies adopted by the 32 local authorities, the difficulty of predicting the future disposable income of older people, and the unpredictable behaviour of individuals in response to any changes in the charging regime.

5.57 The options for care at home outlined in Table 5.8 suggest that estimated cash terms savings of between £99 million and £588 million might be possible (over three years) compared with 2010-11 baseline costs in the last three years of the next Spending Review period (i.e. from 2012-13 at the earliest), depending on the option pursued. Any savings would again be subject to the early and successful passage of potentially complex primary legislation in the first year of the new Parliament.

5.58 The first two options assume a flat weekly fee of around or just below the equivalent Attendance Allowance rate. They would have the least impact on the existing policy objectives. A limit on the maximum number of hours provided free might encourage older people and their families to consider alternative ways of maintaining their independence at home, such as non-paid care.

5.59 Even greater savings could of course be generated by removing all funding support for care, but this would be seen by many, including the Panel, as a draconian step, politically very challenging and contrary to the social objectives of the Scottish Parliament. The Panel recognises that very careful consideration of the direct and indirect consequences would be required. In particular, any option for change would need to be assessed in relation to the need to support people in their own homes.

The Panel suggests that the Scottish Government should consider building on its current consultation on *Reshaping Care for Older People* with a view to taking early action to review eligibility criteria for free personal and nursing care.

PRESCRIPTION CHARGES

"There is an urgent need for an honest and open debate on what the NHS can and cannot afford, and a number of difficult questions may need to be asked: is the move to free prescriptions still affordable?"

BMA Scotland, submission to the Independent Budget Review

5.60 Since 2007-08, when the standard prescription charge was £6.85, the single item prescription charge has been reduced annually in Scotland and currently stands at just £3. The price of a pre-payment certificate (PPC) has also been reduced in parallel. Exemptions from prescription charges cover:

- age (under 16 or over 60);
- a limited number of specified medical conditions; and
- low income.

5.61 The application of prescription charges already reflects an element of means testing based on income. Around half the population of Scotland fall into one or more of these exempt categories. Around 88 per cent of all prescription items are dispensed to people who fall within one or more of the exempt categories. However, a significant proportion of the remaining non-exempt 12 per cent are likely to be able and willing to pay at least the current level of prescription charge.

5.62 Views were expressed to the Panel that prescription charges can deter some people from collecting their medication. This can result in poor management of some chronic health conditions and, in the long run, increased costs to NHSScotland. It is also recognised that there are a number of serious, long-term conditions which do not appear on the exempt list.

"Any system for charging must also be transparent, and consistent across local authorities. It should not place undue strain on those with conditions like Parkinson's where people are expected to require support on a long-term basis. ... People with Parkinson's are commonly prescribed multiple medications to be taken several times a day, and Parkinson's is one of a number of conditions that is not currently exempt from prescription charges. Paying prescription charges causes significant hardship amongst people with Parkinson's on low incomes who may not be able to pay the upfront costs of prepayment certificates from limited income."

Parkinson's UK, submission to the Independent Budget Review

The Panel suggests that the Scottish Government and Parliament should consider suspending the final stage of the planned reduction in prescription charges and take early action to consider charging for non-exempt groups.

NHS EYE EXAMINATIONS

5.67 The then Scottish Executive introduced free NHS eye examinations as a universal service in 2006. Prior to this, a free basic sight test was provided to those under 16, full-time students under 19 and everyone over 60. Sight tests were also provided free for those in receipt of benefits or on low income.

5.68 The current free NHS eye examination allows an appropriate health assessment of each patient's whole visual system, tailored to their symptoms and needs. It also allows for the management of a wide range of common conditions in the community and reduces inappropriate referrals to secondary care.

5.69 In England, Wales and Northern Ireland, there is a charge for eye tests unless the patient falls into certain exempt categories related to age, income or specific health-related issues. The Welsh scheme also provides two special types of eye examinations free of charge for selected categories of patients, including those who may be at greater risk of eye disease and those who experience unexpected acute eye problems.

5.70 In Scotland, the General Ophthalmic Services (GOS) budget provides for the cost of the NHS eye examination and the issue of optical vouchers to eligible people to assist with the cost of glasses and contact lenses. Approximately 75 per cent of this budget represents the cost of the NHS eye examination.

5.71 Data provided by the Scottish Government shows that the introduction of free NHS eye examinations in 2006 resulted in an immediate increase in levels of take-up. In 2009-10, the number of eye examinations was 84 per cent higher than the number of eye tests immediately prior to the introduction of free universal provision. Costs have increased almost four-fold over four years.

Table 5.10

Annual Take-up and Costs of NHS Eye Examinations in Scotland		
Year	Number of eye examinations	Cost (£ million)
2005-06	100,000	10
2006-07	180,000	18
2007-08	200,000	20
2008-09	220,000	22
2009-10	380,000	80
2010-11	400,000	80

*NHS sight tests. Source: Scottish Government

5.72 The Scottish Government introduced changes in 2010 to limit the frequency of free NHS eye examinations, reducing overall costs. Estimated savings resulting from these recent changes are expected to be around £2 million, or around 3 per cent per year, although this will not be confirmed until 2011.

5.73 The Panel heard evidence about the considerable health benefits of eye examinations in identifying eye conditions as well as wider health problems at an early stage, potentially averting longer-term problems.

"The percentage of people who would have been excluded from GOS prior to the introduction of free eye examinations is a fraction of this overall cost – reverting back to the old exemptions prior to 2006 would provide an initial short term saving of around £15-20 million but would lead to an immediate increase in referrals to hospitals and GPs with significant higher costs across all other aspects of the service sector now and in the future."

Optometry Scotland, submission to the Independent Budget Review

5.74 The Panel was also made aware of a recent report by RNIB Scotland on the cost of sight loss in Scotland.¹⁴ The report suggests that the number of Scots with sight loss is expected to double over the next 20 years. The public cost of this is estimated to be at least £194 million per annum. The report includes recommendations that emphasise the importance of prevention.

5.75 It is nevertheless clear that a significant proportion of people who currently benefit from free eye examinations could also afford to pay for them on their own behalf. While the Panel understands that the re-introduction of charging might result in a reduction in the number of eye examinations, with potential consequence for health outcomes, it recognises that there is an option that would involve the re-introduction of selective charging for those with the ability to pay. The Panel has, therefore, considered the possible financial impact of introducing differential fee levels for the eye examination.

5.76 The introduction of charges would require an amendment to the National Health Service (Scotland) Act 1978. Subject to the early and successful passage of the required primary legislation in the first year of the new Parliament, charges for NHS eye examinations could be introduced from 2012-13 at the very earliest.

5.77 Certain groups of people, including children, those aged 60 or over, those on low incomes or with certain sight problems, should continue to be exempt, as they were prior to 2006. These estimated savings assume that the number of people previously entitled to receive free sight tests would remain the same and that the take-up of NHS eye examinations for those who would be charged would drop back to the level of eye tests prior to 2006.

14 www.rnib.org.uk/aboutus/contactdetails/scotland/scotlandnews/Pages/cost_of_blindness.aspx

Table 5.11

Primary Eye Examinations Fee Options: Estimated Potential Annual Savings Compared with Projected Costs (£ million)						
Examination fee options	Examination fee (£)					2010-11
	2010-11	2011-12	2012-13	2013-14	2014-15	
£0	0	15	15	15	15	0
£20	0	22	22	22	22	22
£40	0	31	31	31	31	31

Source: Scottish Government.

Note: Projected costs assume an annual growth rate of 1.1 per cent in uptake and a 5 per cent in cost of primary eye examinations, based on increase in uptake and cost between 2008-09 and 2009-10. Increase between these years was lower than previously. That trend is expected to continue due to the changes which were made on 1 April 2010 to the frequency of primary and supplementary eye examinations.

Table 5.12

Primary Eye Examinations Fee Options: Estimated Potential Annual Savings Compared with Baseline Costs (£ million)						
Examination fee options	Examination fee (£)					2010-11
	2010-11	2011-12	2012-13	2013-14	2014-15	
£0	0	15	15	15	15	0
£20	0	22	22	22	22	22
£40	0	31	31	31	31	31

5.78 Introducing charges of between £20 and £40 for an NHS eye examination for non-exempt categories of people could generate total estimated savings of between £46 million and £93 million compared with projected costs over the next Spending Review period. This represents total savings of between £36 million and £72 million compared with baseline costs in 2010-11.

5.79 If a charge for NHS eye examinations were to be introduced and if optometrists continued to determine their level of private fees, it is possible that some optometrists might choose to charge less than the options set out above, further reducing take-up levels for NHS examinations. Additional savings would accrue if there were to be a further drop in the number of NHS eye examinations.

The Panel suggests that the Scottish Government and Parliament should consider immediate action to review eligibility for free NHS eye examinations and to continue to work with the optical profession to identify any further action needed to control costs.

FREE SCHOOL MEALS

"Cost is a key factor in choosing not to eat a school meal for 21% of primary and 31% of secondary school pupils. Evaluation of the Scottish pilot free school meal programme and of universal free school meal programme in Hull shows that universal provision massively boosts take up of healthy school meals, with real potential for boosting children's health and learning, as well as relieving pressure on family budgets."

Child Poverty Action Group, submission to the Independent Budget Review

5.80 The Scottish Government's free school meals policy is reflected in the Concordat with local government as two commitments:

- extension of free school lunches to all primary school and secondary school pupils whose parents or carers are in receipt of both maximum child tax credit and maximum working tax credit; and
- extension of free school lunches to all P1 to P3 pupils.

5.81 The first of these commitments is primarily a means tested measure to tackle poverty and was introduced in August 2009.

5.82 The second commitment is aimed at improving health from a young age. It extends provision of free school meals beyond children in poverty who currently benefit and was due to commence in August 2010. However, it was recently confirmed by the Scottish Government that local authorities will have flexibility in delivering on this commitment and may implement a similar alternative scheme. For example, local authorities may provide a free meal to all P1 to P3 pupils in schools within 20 per cent of the most deprived communities in their area.

5.83 Free school meals are also available in England and Wales. Eligibility is determined based on parents' or guardians' access to income support, other benefits or annual income of less than £16,040.

5.84 Assessing the additional costs of rolling out free school lunches in Scotland is extremely challenging, especially as discussions on how this will be achieved in each local authority area are currently ongoing and because each local authority has responsibility for allocating funding.

5.85 This policy is already focused on the less well-off and the very young in contrast with the original policy intention, which was for a universal scheme. The Panel noted the recent changes which appear to be leading towards a more closely targeted scheme and the variations in approach being adopted locally. The Panel is also aware of the need to ensure early intervention to ensure a positive impact on health and poverty. It has not identified any clear options for further change in relation to free school meals provision at this time.

The Panel welcomes ongoing work to target free school meals to improve health and to tackle poverty, and looks to the Scottish Government and Parliament to continue to monitor the impact of this policy.

GRADUATE CONTRIBUTIONS AND TUITION FEES

"It is clear that Scottish Universities and other colleges are facing difficulties competing internationally because of their reliance on public sector funding, which in turn places a significant burden on the budget. SCC recommends that the Scottish government looks at alternative sources of finance for higher education. Examples include fees backed by bursaries for poorer student, a graduate tax, bond issuance backed by future graduate payments based on income, or encouraging philanthropy."

Scottish Chambers of Commerce, submission to the Independent Budget Review

5.86 The costs of tuition fees are provided as a non-means tested universal benefit in Scotland for eligible students undertaking a full-time undergraduate course of higher education. European Union (EU) law also requires the Scottish Government to pay the costs of tuition fees for EU students, of whom there are currently in excess of 10,000. The Student Awards Agency for Scotland pays fees to Scottish colleges and universities¹⁵ on behalf of such eligible students.

5.87 This currently requires a public contribution of £1,285 per year for each HNC/HND student and £1,820 for undergraduates, except for medical students where the fee is £2,895. Part-time higher education students are currently entitled to up to £500 fee support, which is the level charged by most institutions. In 2009-10, the total cost of fee support for higher education students studying in Scotland was just over £200 million.

5.88 Student loans are also available for all students in higher education. Students resident in Scotland are entitled to a minimum loan of £915, up to a maximum of £6,152 if living away from home (or £605, up to a maximum of £4,107 if staying at home) from the Student Loans Company. There is a cost to the public purse of 31 per cent for every loan advanced. In 2009-10, gross loans advanced were around £202 million. Of those advances, a sum of around £63 million was for universally-available minimum loans, with an associated cost to the Scottish Government's DEL budget of £20 million.

5.89 In England, the Higher Education Act 2004 replaced the previous up-front, flat fee for English and EU undergraduates with deferred variable fees. The previous charge for tuition of approximately £1,000 was replaced by one where universities could choose what fee to charge, up to a cap of £3,000 per year rising in line with inflation. The Act also required universities that charge

¹⁵ The term 'universities' is used here to refer to all Higher Education Institutions.

the maximum fee to provide students from low income backgrounds with a bursary of at least £300 and established the Office for Fair Access. The reforms introduced Government-backed loans to cover fees.

5.90 Universities in England currently charge a tuition fee of up to £3,225 per year for full-time undergraduate courses which is due to increase to £3,290 in academic year 2010-11. In most cases, this is funded from a loan from the Student Loans Company which begins to be repaid once the graduate starts earning £15,000 per year. Interest rates on student loans are subsidised and do not reflect the true cost of borrowing to the UK Government. As a result, graduates only pay back the money borrowed at today's prices.

5.91 The introduction of fees in England in 2006 was accompanied by the introduction of additional student support. There is some evidence that higher education participation by young people living in the most disadvantaged areas of England may have improved since 2006. This is likely to reflect the introduction of additional student support in parallel with the introduction of fees in England.¹⁶

5.92 In Wales and Northern Ireland, fee loans are available to cover the cost of variable fees at the same level as in England. The levels of means-tested grants and maintenance loans in Wales and Northern Ireland are broadly similar to those in England.¹⁷

5.93 A major review of higher education funding and student finance in England (the 'Browne Review') is under way and is expected to report to the UK Government in autumn 2010.¹⁸ The Browne Review is considering the balance of contributions by taxpayers, students, graduates and employers and will make recommendations on the future of fees policy and financial support for students in England. The review is also likely to make recommendations on changes to the current cap on variable tuition fees in England.

5.94 The implications of the Browne Review for Scotland could be considerable. Any reduction in the level of public subsidy for higher education in England could also have a negative impact on the Scottish Government's budget through the Barnett formula.

16 See Independent Review of Higher Education Funding and Student Finance, *Call for Proposals* (March 2010) <http://hereview.independent.gov.uk/hereview/call-for-proposals/>

17 This reflects the position in 2010-11.

18 The Independent Review of Higher Education Funding and Student Finance, *Call for Proposals* (March 2010) <http://hereview.independent.gov.uk/hereview/call-for-proposals/>

5.95 The Panel is of the view that, if the UK Government decides to increase or remove the cap on tuition fees in England, the Scottish Government will need to respond to ensure that universities in Scotland maintain their competitive position. In the context of the current financial challenges and the recognised benefits of higher education for individuals, there is an even more pressing need to have an open debate in Scotland on the contributions which students and graduates make to the cost of higher education.

"Graduates should contribute towards the cost of their higher education by means of a deferred fee to be repaid once they earn more than the Scottish average salary – Higher education cannot be seen as an entitlement in the way school education is – it is something that has to be academically achieved. ... While it is true to say that society as a whole benefits from having a well-educated workforce, the individual graduates themselves also benefit from the higher earnings they accrue. At present, only wider society pays for graduates through the tax system, while the graduate does not contribute. ... There needs to be a better balance with the individual graduate as well as taxpayers contributing towards higher education."

Power to Learn,

Paper for Reform Scotland by Ben Thomson, Geoff Mawdsley and Alison Payne (June 2010)

5.96 The graduate endowment fee was a form of graduate contribution which was abolished by the Scottish Government in 2008. A so-called 'graduate tax' is a variation of this which may be worthy of consideration. However, its introduction would be very challenging. Revenue streams from a graduate tax would only start to emerge strongly after five years or more – beyond the period of the next Spending Review – and the administrative costs might be significant. Legal powers to implement such a tax are wholly reserved to the UK Government. There would also be a number of cross-border challenges to be addressed.

"We are not opposed to looking at distinctively Scottish funding models which maintain international excellence and protect wide access, but there is a lot of work to do to establish whether there is any model which would secure these objectives while avoiding the pitfalls of the English system including its very high cost to Government (it currently costs as much to administer as it raises for universities, because of additional student support costs of subsidised loans). If the Ministers of a post-2011 Scottish Government were minded to legislate for an alternative funding model we could not expect to see any realisable benefit during the SR2010 period."

Universities Scotland, submission to the Independent Budget Review

5.97 The Panel is of the view that the (re)introduction of tuition fees in Scotland on a similar basis to that likely to be proposed in England appears to be a further option worthy of serious examination in the current financial context. The position in England may of course evolve following the outcome of the Browne Review. Such an approach should ensure that higher education continues to be free at the point of entry for the undergraduate. It might be possible to start implementing this from 2012-13 so that any savings could be generated within the next Spending Review period. Income from fees might also be seen as a way of offsetting any budget reductions in the Scottish Government's allocation to the Scottish Funding Council while maintaining universities' competitiveness.

In relation to tuition fees the Panel recognises the importance of the Browne Review and the implications it may have for higher education in Scotland. It also recognises that the appropriate time to take action in Scotland is once the outcome of the Review is known. In that context, the Panel suggests that the Scottish Government and Parliament should consider whether to maintain the current funding arrangements or to implement a scheme similar to that in England, such as tuition fees, or other alternative arrangements such as graduate contributions.

CONCLUSIONS

5.98 The operation of free or subsidised public services on a near universal basis over the last 10 years has benefited a wide range of people, including those who might have had the resources to fund them themselves. Unfortunately, demography and other drivers are expected to continue to stimulate demand and inflate costs to levels which appear to be unsustainable. The issue is not one of desirability, but of affordability.

5.99 There is a pressing need to review the current approach in order to reduce future inflationary cost pressures and to ensure a more sustainable approach to funding. The Panel considers that there is scope to look again at eligibility, as well as the selective introduction of means testing and user charging for all universal services. This will help to ensure that public services are focused on those with greatest need as well as helping to control future costs.

5.100 The Scottish Government should build on the indicative analysis of universal services in this chapter and take forward further, more detailed work as soon as possible to consider savings that could possibly be made within the next Spending Review period, taking account of the impact on those in greatest need. The scale of the savings has the potential to make a significant contribution to filling the projected funding gap.

Meeting the Challenge of Budget Cuts in Scotland: Can Universalism Survive?

David Bell, April 2010

1. Introduction

During the next few years, the budget available to the Scottish government to buy goods and provide services for the people of Scotland will be cut. There are questions over the timing and the extent of the cuts, but the general direction is clear.

This means that services will have to be provided more efficiently, or there will have to be a reduction in the range of services provided. So far, the debate in Scotland, and in the rest of UK, has focused on efficiency savings – producing the same public service output with fewer inputs. In political terms, this is easy to sell because it is relatively easy to persuade the electorate of the benefits of reducing waste and inefficiency. But many informed commentators are sceptical that efficiency savings alone will achieve the intended reductions in the UK deficit and that they can be achieved with relatively little pain.

One reason for this scepticism is the perceived ineffectiveness of previous efficiency programs. The 2004 Efficiency Saving programme, initiated by Sir Peter Gershon, did not fully achieve its objectives. Thus, for example, the National Audit Office found that 24% of the reported savings in the Department of Transport may have been doubtful, while 17% gave significant cause for concern. Its director, Amyas Morse, argued that: "A failure to deliver these savings may mean cuts having to be made elsewhere."¹

Professor Colin Talbot, in recent evidence to the Treasury Select Committee argued that: "The strict definition of efficiency is the relationship between inputs and the outputs, both quantity and quality of outputs that are achieved. One of the problems that we have always had is that we have not really had robust measurement of output. It is very easy to claim efficiency savings in terms of cash savings in terms of inputs: without the measurement of outputs it is very difficult to say whether they are real efficiency savings or simply cuts."²

And Robert Chote, Head of the Institute for Fiscal Studies, writing about the March 2010 budget, argued that: "if they are cutting out genuine waste we would expect the Government to try to achieve most of these efficiencies even if it was not having to cut public spending overall. Efficiency savings that can and should be delivered in any event do not narrow the gap between the quality and quantity of public services that we would enjoy with spending cuts and without them. They are not free money and they do not mean that spending cuts are painless."³

¹ Amyas Morse, Head of the National Audit Office, 16 December 2009

² Professor Colin Talbot, <http://www.publications.parliament.uk/pa/cm200910/cmselect/cmtreasy/uc530-i/uc53002.htm>

³ <http://www.ifs.org.uk/budgets/budget2010/chote.pdf>

If efficiency savings alone are not able to deliver the necessary reductions in spending, then cuts in the range and scope of public services, or increases in the charges that service users must pay, have to be contemplated. This requires a different approach from that associated with making government bodies deliver better value. Changing the composition of public services is an issue of politics and philosophy, rather than of management.

This paper focuses on one of the main issues of principle associated with changing the structure of public services in Scotland. This is whether services provided by the Scottish government should be universal or means-tested. This is largely a political issue and therefore involves questions of redistribution, justice and social acceptability. But it is not a novel question historically and it is not unique to Scotland. The balance between universal provision and means-tested benefits in different countries reflect different value structures and political realities. However, during the last decade, when resources were growing rapidly, successive Scottish governments have not needed to focus attention on this question. The reductions in the budget that are in train imply that avoiding the question is no longer tenable.

Indeed, this has been recognised in the terms of reference for the Independent Budget Review, which was recently set up by the Scottish Government to look at the future of Scotland's public finances. Specifically, item (viii) of its terms of reference suggests that in forecasting future spending programmes, it should take into account "distinctions between public goods and services that are provided on a universal basis and those which are not."⁴

This paper begins by rehearsing some of the main arguments for and against universalism and means-testing. It then examines how successive Scottish governments have selected policies which reflect an implicitly universalist or selective approach. It concludes by assessing the relative merits of the two approaches in fiscal terms, making some suggestions about how the Scottish parliament might address this issue in the future.

2. Universalism and Means Testing: the Philosophical Debate

Governments providing services must decide who should be eligible to receive the service and how much they should be charged. The key difference between universalism and means-testing is whether individual income or wealth influences eligibility and charging. With universalism, service provision is not conditional on income or wealth. Other conditions may be used to define the group eligible to benefit from the service e.g. age. With means-testing, income or wealth is established as well as any other qualifying conditions, and then rules are applied to determine the charges that should be paid. Thus, for example, Scottish local authorities charge for non-personal social care after an assessment of need *and* a means test.

⁴ Scottish Government: Independent Budget Review (2010) accessed at:
<http://www.scotland.gov.uk/Topics/Government/Finance/18127/independent-review>

Taxpayers meet the costs that are not covered by charges. These taxpayers may belong to the current generation of workers. But if the money to pay for the service is borrowed by the government, then it is future generations of taxpayers that meet the cost. The implicit contract is that current and future taxpayers are willing to transfer resources to pay for services consumed now. Committing future generations to pay for today's spending clearly raises issues of fairness and justice. These have been extensively discussed in other jurisdictions (e.g. Australia⁵) and by UK politicians⁶.

Because means-testing means that costs are shared between service users and taxpayers, the costs to taxpayers are lower than under universalism. And because clients are contributing towards the cost of service, they may have a greater interest in directly influencing its value for money or quality.

Another way to conceptualise the contrast between means-testing and universalism is in the extent to which the state insures the individual against risk. Developed countries tend to insure the individual against a variety of risks. But the set of risks covered and the requirement for charges or "co-payment" (sharing of risk) varies widely from country to country. For example, the UK government fully insures individuals against the costs of ill health through the National Health Service. But in the USA at present there are around 48 million individuals with no health cover and many others who rely on the private insurance market to pay for their health care.

Both private and public insurance schemes have to guard against moral hazard - the possibility that the insured, knowing that they are covered, do not try to avoid the risk. An example might be where provision of unemployment insurance reduces the willingness of workers to avoid losing their jobs. The universalism/means testing debate can be framed using this analysis of risk. Universalism implies that greater numbers of individuals stand not to lose from adverse events and therefore is more likely to lead to problems of moral hazard.

The main arguments for means testing and against universalism are:

1. Resources are targeted where they are most needed, leading to lower overall costs compared with universal benefits. Resources are released to other government priorities or taxes can be reduced.
2. Services are not offered to those who could afford and would be willing to pay. Providing a service to those that are willing to pay is a 100% deadweight loss to the taxpayer.
3. Provision of universal benefits can interfere with market provision. Markets may not be efficient where the state is the main purchaser.
4. Provision of free services can lead to inflated demand. This is a variant of the moral hazard problem.

⁵ Thompson, J. (2003) [Research Paper no. 7 2002-03 Intergenerational Equity: Issues of Principle in the Allocation of Social Resources Between this Generation and the Next](#). Social Policy Group for the Parliament of Australia.

⁶ See e.g. Willets(2010) "The Pinch: How the Baby Boomers Took Their Children's Future - And Why They Should Give it Back", Atlantic Books

5. Universal benefits are difficult to rescind because they are often seen as entitlements whose removal can be legally contested. Means-tested benefits, on the other hand, are more easily varied. Thus, for example, it may be relatively easy to vary the willingness-to-work conditions associated with unemployment insurance. But removing the right to free health care would be well-nigh impossible politically.
6. Because clients are directly contributing towards some share of the costs, they have a greater incentive to improve the quality of service or make it more efficient.

The main arguments for universalism and against means-testing are:

1. Korpi and Palme (1998, p. 663) have argued that there is a 'paradox of redistribution' whereby 'the more we target benefits to the poor . . . the less likely we are to reduce poverty and inequality.' Highly targeted programmes have a limited support base. They tend to result in conflict between those above and below the means test limit. Such programs therefore have limited appeal to the majority of voters that are above the means-test limit. Universal programs have a much broader political support. Means testing may undermine public support for those receiving benefits.
2. Along similar lines, universal policies may increase the preference for redistribution by generating a more cohesive group identity. Thus, for example, Scandinavian countries have highly redistributive tax systems that are based around universal rather than means-tested benefits.
3. Means testing causes stigmatisation. It inevitably focuses arguments around who is "in" and who is "out" and whether those that are "in" are "deserving".
4. Many people, particularly the elderly, do not take up means tested benefits even when eligible. But as Hancock et al (2005) argue, take-up is greater among those with greater entitlement.
5. Universalism is less costly to administer since the process of means-testing itself uses significant amounts of resource. Often means tests are carried out by those delivering the service e.g. medical professionals, which can create conflicts of interest.
6. Means-testing discourages savings because individuals have an interest in letting their assets fall below the means-test limit, knowing that they can then receive services free. But universal provision also discourages saving because it guarantees a certain level of service, irrespective of the level of saving.

Lester (2010) summarises the arguments in favour of universalism. "Universalist programs, I argue, plausibly increase preferences for redistribution by tapping social norms of reciprocity, generating group identity effects based on a sense of common vulnerability, and serving as a "policy frame" that de-emphasizes the salience of low-income people as an undeserving "out-group.""

However, an important difficulty with arguments relating to building up a communal culture of support for universal benefits is that such a culture is only likely to evolve slowly. Budget crises generally have to be addressed over a much shorter time horizon.

In the present situation, therefore, the argument that means testing is more fiscally efficient, at least in the short-run, may supersede all other arguments.

3. Scottish Government Policy

Since the introduction of devolution in 1999, successive Scottish governments have tended towards the universalist rather than the means-tested approach to the provision of benefits. Thus, for example, free personal care is available to all older people who require it, irrespective of income or wealth. The argument in favour of universalism is that personal care and health care, which is provided free at the point of delivery, are difficult to distinguish. Thus, it is claimed, it is unfair to require individuals to pay for the costs associated with dementia, while cancer care is provided free. This policy has not been adopted in the rest of the UK, though the Westminster government has recently come close with the promise to provide free personal care for older people at home with critical care needs in England. In 2007-08, the cost of free personal care was £352m. Bell (2010) reviews how social care in other parts of the UK is paid for through a mixture of charges and payments by both devolved and UK governments. He argues that the different strands of public support make for a highly complex system that is difficult for clients to understand. Attendance Allowance and Disability Living Allowance, neither of which is means tested, are paid by the Department for Work and Pensions to older people in Scotland who are assessed as requiring personal care. In 2007-08, the costs of these DWP benefits in Scotland exceeded the costs of free personal care. Nevertheless, Scotland has opted for the most universalist approach to the provision of social care within the UK because it additionally supports non means-tested personal care provided by local authorities.

The Cubie Report (1999) recommended the introduction of a “graduate endowment” as a student contribution towards the costs of higher education. The Graduate Endowment and Student Support Act (2001) introduced this measure, with the endowment payable after graduation. In 2006-07, the contribution expected from each graduate was £2289. This was payable from the April following graduation. In 2008, the endowment scheme was abolished. The immediate cost to the Scottish budget was £17 million. Though graduates in Scotland benefit financially from higher education, they do not directly contribute towards its costs. Therefore taxpayers pay a larger proportion of the costs of higher education in Scotland than in the rest of the UK. In England, tuition fees for undergraduates raised £1.9 billion in 2007-08. A significant proportion of these funds were used to provide bursaries for students from disadvantaged backgrounds. This implies that in England, there is redistribution from the families of richer students to those of poorer students. Lord Sutherland⁷ recently suggested that tuition fee policy in Scotland should be re-examined, pointing out that only 26% of students in Scotland come from poorer backgrounds, compared with 40% in Northern Ireland and 30% across the UK as a whole. The current university funding system points to a more universalist approach in Scotland than in the rest of the UK.

⁷ See: <http://news.bbc.co.uk/1/hi/scotland/8246907.stm>

The national travel concession scheme provides free bus travel Scotland-wide for older and disabled people. It was introduced in 2006. The measure is expected to cost £194m in 2010-11. Provision of this benefit is conditional on age, but not on income.

Other measures cost less, but also suggest a more universalist approach in Scotland. These include the abolition of bridge tolls on the Forth and Tay Bridges. This measure particularly aids drivers, who are generally above median income. Abolition of prescription charges will aid those that do not already receive free prescriptions. These tend to be workers, who are generally more capable of contributing towards prescription costs. Freezing of council tax aided those that did not already have their council tax paid through council tax benefit. Again, this is generally more affluent householders. All of these measures have been at least partially regressive.

It is also important to recognise that Scots are also affected by the provision of universal or means-tested benefits by the UK government. Thus, for example, Child Trust Funds and Winter Fuel Allowances are given as universal benefits at different ends of the age spectrum. Most UK social security benefits are means tested, though, as mentioned above, Attendance Allowance and Disability Living Allowance are important exceptions.

Finally, it should be noted that the size and distribution of major items of expenditure within the Scottish budget are influenced by indicators which are linked to levels of affluence and deprivation within Scotland. This implies that some services which are provided free are nevertheless weighted towards areas of deprivation and low income. A good example is the Arbutnott formula which is used to allocate spending between health boards and which reflects levels of deprivation (and therefore implicitly income). Similarly, allocations by the Scottish government to local authorities reflect differences in affluence across Scotland. Similar systems are in place for allocating health spending and local government spending in England and Wales.

4. Conclusion

Efficiency savings will neither be easy nor painless. Because of the size of the cuts that will be necessary in the next few years, the Scottish government may have to re-examine commitments that have been made in the last decade to universal, rather than means-tested benefits. The evidence suggests that Scotland has committed itself to a larger set of universal benefits than other parts of the United Kingdom in the last decade.

There is a real philosophical debate on the relative merits of means tested as opposed to universal benefits. Universal benefits work well within a Scandinavian system where there is huge public acceptance of high tax rates coupled with universal benefits. This may be a model to which Scotland might aspire in the long run, but at present, due to the short timescale over which very significant cuts are likely to be required, the arguments for extending means testing have to be reconsidered. Where efficiency savings may really mean cuts, the argument that those able to contribute more towards the costs of public services might be asked to do so, cannot be ignored.

Universal commitments, once given, are extremely difficult to withdraw. While budgets were consistently increasing in real terms, it may have seemed that there would never be a need to revisit these. Recent experience suggests that assumptions of consistent long-term growth in tax revenues and in public services were seriously misplaced. These assumptions were not particularly the fault of the Scottish government, since a wide range of forecasters, both private and public, had accepted this scenario.

Nevertheless this experience should provide lessons for the way the Scottish Parliament conducts its business in future. In a world where revenue is much less certain, open-ended universal commitments often provide hostages to fortune. They may significantly distort the overall budget. For example, although the Scottish Government's main purpose is to promote sustainable economic growth, it is surprising that between 2006-07 and 2010-11, spending on Concessionary Fares has increased by 19 per cent, while spending on Enterprise and Tourism has fallen by 33 per cent.

In the light of the impending cuts and the difficulties associated with efficiency savings that have been highlighted in this paper, the committee might like to consider the following proposals:

1. Legislation with budgetary consequences should avoid open-ended commitments. This might be done in a standardised way within legislation, by insisting that relevant Bills cite conditions under which charges and means-testing might be applied or benefits withdrawn.
2. The Finance Committee, in conjunction with the Financial Scrutiny Unit, should extend its purview over legislation to include not only financial memoranda, but also its potential distributional effects across the Scottish population, both for the current and future generations. This would help build up a picture of how different pieces of legislation affect rich and poor communities within Scotland.
3. Financial Scrutiny Unit should be asked to look at the benefits (both cash and in-kind) accruing to the Scottish population not only as a result of the actions of the Scottish Government, but also those of the UK and European legislatures. This would avoid confusion, for example, about the overall size of the universal benefits accruing to Scottish pensioners, some of which are paid for by the Scottish Parliament and some by the UK Parliament.

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ANNEX E

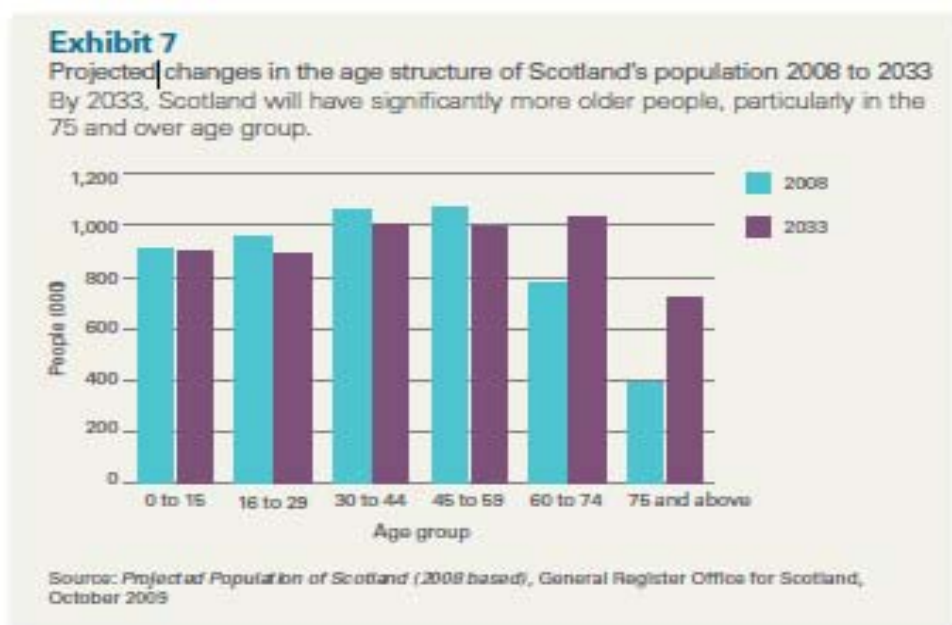
EXTRACT FROM AUDIT SCOTLAND REPORT - SCOTLAND'S PUBLIC FINANCES: ADDRESSING THE CHALLENGES

Changes to Scotland's population profile will increase the demand for public services

31. There will be a significant change in the demographic profile of Scotland's population over the next 25 years, which will increase demand for public services in many areas. Projections show that over the period 2008 to 2033 the number of people aged 60 and over will rise by 50 per cent from 1.17 million to 1.75 million, with the number of people aged 75 and over set to almost double. The number of people aged 16 to 59 will decrease by six per cent from 3.09 million to 2.89 million

32. As a result of these demographic changes, the ratio of older people to those of working age is expected to increase from the current 31 older people per 100 workers to 40 older people per 100 workers by 2033. Having relatively fewer people of working age to support older people has a number of consequences including:

- Fewer people to deliver public services and care for others.
- Fewer people to contribute to pensions putting strain on pension funds.
- Fewer people paying national insurance and tax, reducing tax revenues.
- Larger proportion of working people's income needed for pensions and national insurance which reduces their disposable income.
- A greater proportion of future tax revenues generated from the working population will be required to pay for older people's health and social care needs and pensions.



33. Demand for health and social care services is particularly high among older people, particularly those aged 75 and over. An increasing older population is likely to lead to more people living longer with health problems such as diabetes and chronic obstructive pulmonary disorder requiring ongoing care. At the same time, the public's expectations of services delivered by the NHS have risen. For example, it

may be difficult to maintain recent improvements in waiting times for treatment when there is significantly higher demand for these services.

The demand and cost of free services continues to rise

34. The Scottish Government remains committed to a number of universal public services such as free prescription charges, free eye tests, concessionary travel and free personal and nursing care where the costs are increasing. These services are demand led, making it difficult to estimate their future costs. However, given the expected rise in the number of older people in Scotland, the likelihood is that, unless changes are made to areas such as eligibility criteria, demand for these services will increase costs.

35. In 2010/11, the combined cost of free personal and nursing care, free prescriptions, free eye tests and the national concessionary travel scheme cost around £870 million and the costs are rising. The Scottish Government has yet to take forward the Independent Budget Review Panel's recommendation that all universal services should be reviewed to see if they should be maintained in their current form, focusing on changes in eligibility criteria, the introduction of charges and to ensure that those who need these services most are not disadvantaged. Our report on the national concessionary travel scheme stated that the scheme cost £199 million in 2009/10 and that costs are expected to rise. We projected that, based on current levels of concessionary journeys and a range of fare increases, the uncapped costs of the scheme could reach between £216 million and £537 million by 2025.

FISCAL SUSTAINABILITY

ISSUES FOR THE FINANCE COMMITTEE WORK PROGRAMME 2012

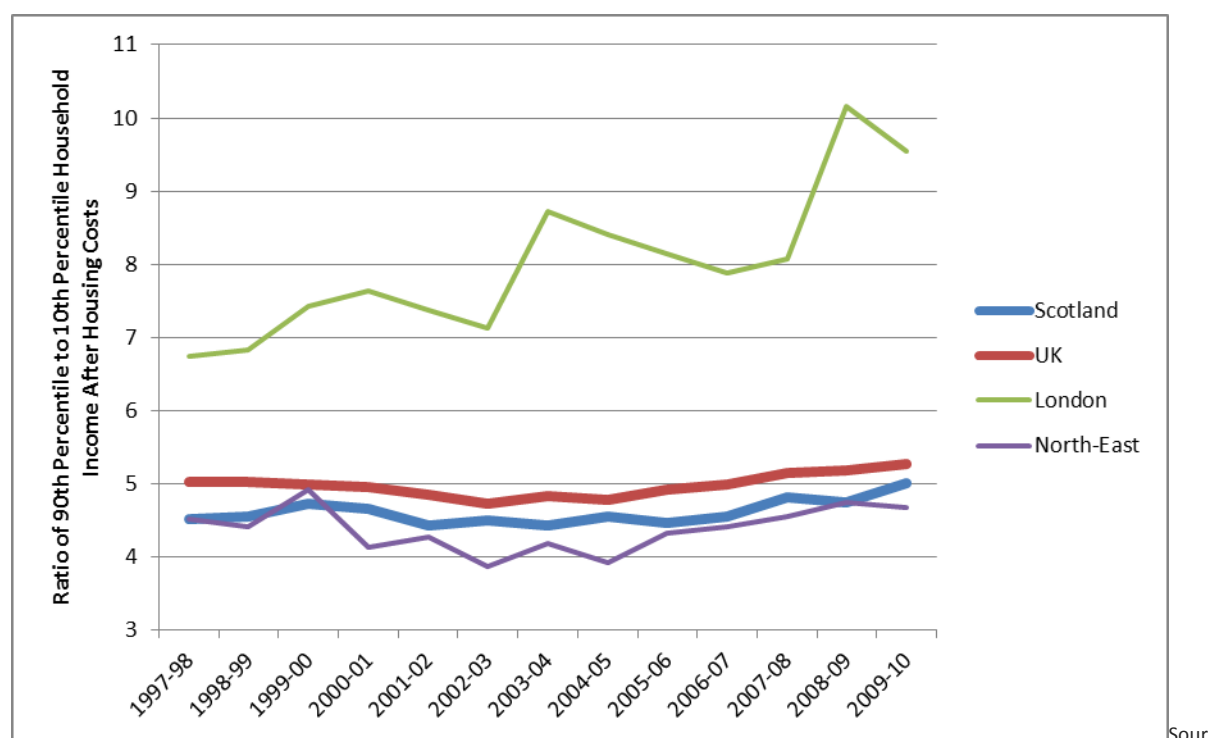
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January 2012

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Figure 1: Ratio of 90th to 10th Household Income Percentile (After Housing Costs) 1997-98 to 2009-10, (OECD Equivalisation Measure)



Source: Households Below Average Income, Office of National Statistics

Deprivation tends to be generational. The Chief Medical Officer, Harry Burns, has argued that some of Scotland's most deprived communities have little interaction with the rest of Scottish society. He also argues that early years intervention can play a vital role in improving the health, well-being and development of young people in Scotland in the deprived areas.

The Committee may want to consider how inequality, poverty and the lack of social mobility affects economic performance and the costs of provision of public services in Scotland.

Universal services

I have touched on the issue of universal services in a previous paper for the Finance Committee¹. This section follows the same general lines of argument. It deals first with some philosophical issues and then discusses some practicalities.

One way to think of universal benefits is that they provide the citizen with full insurance against certain risks. The UK is almost unique in providing full insurance against healthcare needs - the

¹ Bell, D. (2010) "Meeting the Challenge of Budget Cuts in Scotland: Can Universalism Survive?", Scottish Parliament, http://archive.scottish.parliament.uk/s3/committees/finance/inquiries/budget/documents/BSP_adviser1.pdf

National Health System. Scotland provides full insurance against the need for personal care.

Countries differ substantially in the range of risks that they cover for their citizens and in the extent of cover. Full coverage implies that the service is free: less than full insurance implies that the individual has to make a co-payment (or contribution) towards the cost of the service. Most European countries' health systems involve co-payment.

Means testing implies cost sharing. Costs to taxpayers are generally lower under means testing compared with universalism. There is a danger of moral hazard with full insurance. This means that the insured do not take actions to avoid the risk. An example is unemployment insurance, which may make workers take less action to avoid losing their jobs and to get back into employment.

Where services are offered to those that are willing to pay, the taxpayer loses out. One example of such willingness to pay is the increasing participation in schemes to redirect their Winter Fuel Allowance to charity. Some citizens clearly feel that this benefit should be means tested, rather than universal. This is in the same way as an example of Lester's² argument that universal benefits emphasise common group identity and reduce the focus on the "undeserving" poor.

On the other hand, universal benefits are difficult to rescind because they tend to attract supporters with the ability to deploy political pressure to resist change. By definition universal benefits will be offered to parts of society that are more able to mobilise political support than are the poor. Current and future taxpayers are rarely as well organised – and anyway, the loss to the individual taxpayer will be much smaller than the gain to the recipient of a universal benefit.

Universal benefits may also increase societal preference for redistribution, since the benefits of the system are seen to be available to all. In contrast, means testing may lead to the stigmatisation of those receiving benefits. Means testing also discourages savings because individuals have an interest in letting their assets fall below means test limits. This issue is particularly important in relation to long-term care, not just in Scotland, but throughout the UK. Current means testing limits of £23,000 encourage older people to divest their assets either through consumption or bequest. As mentioned previously, one of the proposals put forward by the Dilnot Commission on social care in England, which may apply to Scotland, is that this limit increase to £100,000. This should reduce the extent of dissaving by older people.

At a practical level, any spending saved by the imposition of means testing has to be set against the costs of administering means testing. This can be both expensive and intrusive. Attempting to fine

2 Lester, G., (2010) "Can Joe the Plumber Support Redistribution?" Law, Social Preferences, and Sustainable Policy Design. Tax Law Review, Vol. 64, 2011. <http://ssrn.com/abstract=146109>

tune systems to maximise taxpayer benefit may be self-defeating due to increasing administrative costs.

Means testing also carries risks associated with both fraud and low take-up. Individuals may fraudulently claim benefits by misrepresenting their income and/or wealth. The benefit authorities then have to set up systems to combat fraud. Others who are eligible may not be reached by the system and miss out as a result. Low take-up is thought to be a particular problem amongst benefits for older people, but the evidence suggests that most of those who do not claim would not have received a high level of benefit.

The Commission on the Future Delivery of Public Services³ recommended that the setting of universal benefits in Scotland should be made more transparent. It also recommended changing eligibility rules as a means of managing costs. One difficulty with the control of eligibility criteria is that there is a danger of legal challenge claiming unfairness. This might arise, for example in relation to the non-availability of free personal care to those aged less than 65, the non-availability of free tuition to students from England, but not Scotland or the EU etc.

The Independent Budget Review⁴ was less supportive of universal benefits: The Panel believed that the continuing provision of a range of universal services on the same basis as at present is unlikely to be affordable in the face of the projected financial challenges. Alternative approaches should, therefore, be considered as a matter of urgency.” (Independent Budget Review para 5.2).

In particular it highlights

- concessionary travel;
- free personal and nursing care;
- prescription charges;
- eye examinations;
- free school meals; and
- tuition fees.

and discusses a range of savings that might be made across these entitlements by changing eligibility criteria and/or requiring co-payment. However, there might be an argument for putting in place a general mechanism to ensure that decisions about entitlements are not binding on future

³ Scottish Government, (2011) "Report of the Commission on the Future Delivery of Public Services", <http://www.scotland.gov.uk/About/publicservicescommission/>

⁴ Scottish Government, (2010) "The Report of Scotland's Independent Budget Review Panel", <http://www.scotland.gov.uk/Publications/2010/07/29082838/0>

generations. For example, in the US, tax concessions are frequently passed with a time limit, implying that their costs are reviewed periodically.

The Committee may wish to consider how best to monitor the costs of universal services and whether some mechanism, other than by controlling eligibility, should be put in place to ensure that their costs are controlled.

Funding methods

There is a growing consensus that past mechanisms for investment in deprived communities have had limited success. This is based partly on the belief that it the volume of financial support is less important than the incentives facing the stakeholders. As a result, new methods of intervention are being explored. These include payment by results contracts and social impact bonds.

Payment by results schemes involve providing direct incentives to individuals to change behaviours that may be having an adverse effect on themselves or on their communities. This concept can be extended to organisations that receive some financial reward for each client that they persuade to change their behaviours.

Social impact bonds are contracts. Where funding is raised from socially motivated investors aimed at improving social outcomes. If that improvement is verified, then the investor receives their initial stake plus an additional financial return from the government. Verification is almost inevitably because it is very difficult to establish a credible *counterfactual* – what would have happened had the social intervention not taken place.

The size of the financial return is contingent on the size in the improvement in social outcomes. The public sector pays only if the intervention succeeds, reducing the risk that it faces. The focus is on outcomes rather than outputs.

Those involved in trying to improve the social outcomes have to form a contract which takes account of work already being done by the public sector. At present, the main example of such bonds is in Peterborough, where the investors are principally charitable trusts or individuals of high net worth. Once these bonds have some track record, they may be able to attract commercial financial investors.

This is clearly a funding mechanism that is in its infancy. Table 2 below shows the complexity of the processes involved in setting up a social impact bond at HMP Peterborough. Should commercial investors be attracted, a great deal of attention will have to be paid to the nature of the contract to

ensure that the investors behaviours aligned with the objectives of those improving outcomes for those living in deprived areas.