



# **THE INDEPENDENT BUDGET REVIEW**

## **INITIAL CALL FOR CONTRIBUTIONS**

### **Scottish Chambers of Commerce Response**

**Scottish Chambers of Commerce is Scotland's largest business representative organisation, representing 9,500 businesses employing over half of the private sector workforce, with one hundred and seventy staff in the offices of its twenty constituent member Chambers.**

Scottish Chambers of Commerce (SCC) welcomes the opportunity to respond to the Independent Budget Review's call for contributions to its thinking on the prospects for public expenditure in Scotland.

Our submission is based on the assumption set out in the IRB invitation – that the Scottish Government faces significant budgetary reductions over the next three years, and accepts the central estimate of 3.6% (c £1bn) per annum over that period.

This response is, as requested, brief and to the point. We would be delighted to supply further evidence in the second phase of engagements later this year.

The initial call for contributions lists seven questions (section 6) as a framework for responses. Most of these seem to apply to public service providers who would themselves be directly affected by the budgetary reductions. This response confines itself to two key questions (f & g) that have a general relevance to public service reform.

“Are there more fundamental changes to organisational structures or the way public services are provided which you see as essential or desirable in addressing the budgetary challenges facing the public sector in the short or medium term?”

SCC believes that the current budgetary squeeze faced by government in Scotland presents the country both with the necessity and an opportunity for fundamental reform of the way public services are delivered.

If we are to avoid damaging cuts to front line public services, reform is a necessity. But this is also an opportunity to remodel our public sector in a way that will improve the prospects for economic growth and the future as well as better, more customer responsive public services.

The public sector in Scotland has long suffered from a productivity problem. UK wide, the Office of National Statistics has estimated that, in the ten years to 2007 productivity in the public sector fell by 3% while rising by 25% in the private sector.

The situation in Scotland is particularly acute. The Government Expenditure and Revenue Scotland data shows that government spending in Scotland is some 15% higher than the UK average. Yet outcomes are not commensurately higher. In education, pupil attainment has on some key measures fallen behind England, and a recent study by the Nuffield Trust shows that productivity in the health service is well below similar English regions like the North East.

The picture looks even worse on international comparisons. The OECD PISA and other studies show the performance of Scottish schoolchildren falling in relative terms. And we are near the bottom in most studies of health outcomes, despite levels of spending at about the OECD average.

The critical medium term challenge for the Scottish public sector must be to address this productivity problem. In fact the prospects for our public services are good if we can implement meaningful reform. The GERS figures suggest that if we can only get productivity up to UK average levels, the budgetary squeeze could be accommodated. We should aim to do even better than this.

SCC believes that the Scottish Government should look at how public services are provided in other European countries, and learn best practice from them.

Scotland is now one of the few developed nations which persist with a centralized, state monopoly model for public service provision. The norm in other European countries is for a diverse range of competing public service providers, accountable to users who benefit from considerable choice or governance control. These systems are still funded by the state directly, or, in the case of many healthcare systems, through social insurance mechanisms that ensure universal access.

The benefits of such mixed systems are that they exploit market-style mechanisms of competition and consumer accountability to drive performance and productivity improvements while ensuring equity. Indeed, they usually achieve greater equity than centralised systems because good quality is more universal, and wealthier citizens have no need to exit or manipulate the system to find the best providers.

SCC does not recommend any particular model in detail for adoption in Scotland. Reform must draw on the Scottish tradition and fit the aspirations and requirements of the Scottish people, as well as the practical constraints of what we already have in place.

However, there is one particular area which we believe must be addressed, and that is performance measurement.

Scotland has good mechanisms for capturing internal performance data, but this is rendered largely meaningless if there is no comparison against other public service providers in foreign and other UK jurisdictions. Indeed, since devolution, key measures of health service attainment have diverged from UK counterparts, and there is a danger of the same happening in education, making it difficult to judge relative performance, and therefore overall progress. Scottish citizens have no clear idea how good or bad their public services are, and this removes a major impetus for reform.

SCC strongly recommends that the Scottish Government makes every effort to measure public service performance on a like for like basis against other jurisdictions, using independent agencies such as Audit Scotland.

“In the context of the remit and timescale of the Review and of the need for practical options, are there particular key issues which you consider should be addressed by the Panel for the purposes of its report?”.

As well as the general and fundamental approach to reforming public services outlined above, SCC recommends immediate actions in the following areas to help deal with the budgetary reductions.

#### *Public sector pay and recruitment*

SCC believes that labour market conditions in the public sector should broadly reflect those in the private sector so that employment practices come into line with the rest of the economy. Employment costs account for 50% of public sector spend in Scotland. In the current recession the private sector is having to shoulder an increasing burden of paying for a public sector workforce from a shrinking base.

During 2009, ONS figures show that public sector pay rose at treble that in the private sector, and employment continued to rise while falling in the private sector. A number of sensible measures have been suggested by political parties and others to address this and also alleviate budgetary pressures. SCC

recommends that public sector pay in Scotland be frozen in net terms over the next three years, and that recruitment levels be held below the level of natural wastage, resulting in overall payroll reductions.

#### *Public sector pensions*

In the private sector the pensions market has changed rapidly so that most pensions are contribution based whereas, in the public sector, most are still salary based. This is adding to public sector employment costs and therefore the budgetary problem. In the eight years between 2002/3 and 2010/11, pension payments under the teachers and NHS schemes doubled in Scotland to £2.56bn. Encouraging new public sector workers to source pension plans along market norms would go a long way to solving the Scottish Government's budgetary problems in the medium term. A further beneficial effect would be a boost to economic performance since the mismatch distorts the labour market by making it harder for private sector firms to attract key workers.

In practical terms the Scottish Government administers public sector pensions, while their terms are governed by Westminster statute. There is clearly some need for co-operation between the Scottish and UK governments on this question, therefore. In the meantime there is no reason why new employees cannot be recruited under different arrangements in Scotland.

#### *Scottish Water*

SCC recommends that a new way of financing Scottish Water be developed by the Scottish Government. Currently the company relies on an annual settlement with the Scottish Government, due to be £150m in 2010/11. Allowing Scottish Water to access the private capital markets would relieve the Scottish Government of at least this amount annually, and possibly more depending on the final arrangements with the Treasury. It would also give the utility a more secure, long term source of finance that would match its investment needs.

A number of different models have been proposed to address this issue. It may be possible to retain public accountability for the company while it accesses private capital. If not, the Scottish Government should reassess its options with regard to a sale or mutualisation.

#### *Infrastructure and Service Finance*

The Scottish Government is in the process of reforming the way that private capital is accessed to fund publicly used infrastructure, through the Scottish Futures Trust. As the Finance Secretary has pointed out, there is a limit to the extent that assets can be placed 'off balance sheet' through public private partnerships because they rely on a revenue stream from government which is itself limited.

However, SCC believes that the Scottish Government should look at extending the scope of private asset finance. New infrastructure projects could be built entirely by the private sector in return for usage fees or guarantees, and other assets could be sold off under similar arrangements. At the same time the income stream for these assets could be diversified to encourage a mix of private and public sources.

#### *Higher Education*

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.

#### *Contracting Out*

Much of the debate surrounding budgetary efficiencies is focused on the possibility of different government agencies (including local government) 'sharing services' to gain economies of scale and reduce costs. SCC supports these efforts, but would recommend extending their scope to the private sector. There is no reason why government agencies should not commission administrative support, property maintenance, back office work or whole services such as refuse collection from the private sector if it is more efficient.

**Scottish Chambers of Commerce  
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