



Scottish Council for
Development and Industry

POLICY SUBMISSION

DRAFT SCOTTISH BUDGET 2010-2011

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SCDI is an independent and inclusive economic development network which seeks to influence and inspire government and key stakeholders with our ambitious vision to create shared sustainable economic prosperity for Scotland.

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Draft Scottish Budget

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

Economy

2. The context for this draft Scottish Budget is probably the most serious recession facing the Scottish, UK and world economy since the 1930's, which economists have estimated may result in a permanent loss of UK output of 5 to 10%.
3. The UK economy has contracted for six quarters in a row, the first time this has happened since quarterly figures were first recorded in 1955. It is expected to emerge from recession in the second half of the year and confidence is beginning to return, but it is still weak. Manufacturing and service sectors have both reported that domestic orders and sales are still down on the previous quarter. UK industrial output fell in August, and the National Institute of Economic and Social Research has recently revised its estimate for GDP to say that the economy did not grow in the June-to-September quarter.
4. The recovery is likely to be slow and protracted, and there is a significant risk that this recovery may stall or turn negative. Consumer demand remains weak and unemployment is rising. Companies are running down debt and cutting back significantly on investment. The banking sector is lacking equity capital and taking a prudent view of lending to businesses which will reduce their ability to grow. Government spending is expected to begin to decline steeply in real terms from 2010-11.
5. The position in Scotland is even less clear due to the lag in economic data. The latest statistics show that GDP in Scotland fell by 0.8 per cent in the second quarter of 2009 relative to a fall of 0.6 per cent, on a comparable basis, for the UK, and that the service sector fell by 0.4 per cent, the production sector declined by 5.7 per cent and the construction sector fell by 6.3 per cent. Scottish manufactured export sales fell by 0.7 per cent in the second quarter of 2009 and by 8.5 per cent over the year until the end of June. Latest figures published by the Office of National Statistics show that unemployment rose by 13,000 over the three months to August while the claimant count rose by 300 on the month.
6. The Fraser of Allander Institute's latest Economic Commentary's central forecast is for a decline in GDP/ GVA of 2.9% in 2009. A robust recovery is not anticipated. The central scenario is for growth of 0.6% in 2011 and 1.4% in 2012, still some way below the 1.9% growth trend, and behind the UK as a whole. Its central scenario for jobs predicts losses this year and next amounting to nearly 137,000 to peak at 212,600 or 6.2% in 2010 on the International Labour Organisation measure. Net job creation in 2011-12 would be just over 28,000.

Rebalancing and Internationalising the Scottish Economy

7. In the last decade the Scottish economy has become more of a service sector economy as the manufacturing share declined. SCDI's Surveys of Scottish Manufactured Exports has shown that they peaked at just under £20bn in 1999 and have averaged around £15bn in 2003, dropping to £14.6bn in 2007. As electronics exports have fallen, the economy has become more dependent on financial services, construction, business services and the public sector. Action to stimulate domestic demand vital, but as Bank of England Governor Mervyn King has identified these sectors are likely to be weaker over the next ten years, and a key challenge will be to rebalance the economy with "more resources devoted to business investment and net exports and fewer to consumption." The key choice for the Scottish economy is the balance between consumption and investment. In SCDI's view, higher sustainable economic growth in the long-term will require a higher priority for investment and internationalisation, and the Scottish Budget needs to support this purpose.
8. Manufacturing still accounts for the bulk of Scotland's exports. The weakness of the pound over the last year has provided a boost to its global competitiveness. However, if the Scottish economy is to be rebalanced, its high-value manufacturing exports base will need to grow substantially and diversify. The UK and Scottish Governments have indicated that a new era of industrial activism is necessary to develop low carbon technologies, advanced manufacturing, life sciences, and digital and creative media. Support for higher levels of business birth rate and business R&D is needed and, above all, to attract the significant inward investment which is necessary to widen the manufacturing exports base.
9. A strong, diverse and competitive Scottish financial services sector will boost domestic demand, and support internationalisation. Even in the difficult financial climate of this year, Scotland has attracted significant inward investment from new entrants to the market. SCDI believes that Scotland's banking sector can bounce back swiftly and robustly, and there may be relatively more jobs retained and created in Scotland than in other parts of the UK over the next three to five years. In SCDI's submission to the Economy, Energy and Tourism Committee's inquiry into *The Way Forward for Scotland's Banking, Building Society and Finance Services Sector* it highlighted the importance of maximising the potential for Edinburgh to host group headquarters functions, business divisions and units, and building on the success of Glasgow's International Financial Services District. A particular opportunity was identified in headquartering "boutique" banks and asset management companies. Inward investment will both increase the number of lenders to the domestic economy and the world class institutions based in Scotland, and it is clear that the significant incentives and support available from the Scottish Government and its agencies are key attractions.
10. The Global Financial Services Index for 2009 has again shown that skills and transport/ airports are regarded by international business leaders as the devolved areas which make the most difference to an economy's competitiveness. An

expanding evidence base indicates that a combination of more effective investments and better exploitation of ICT can play a key role in achieving targets for productivity and economic growth. Internationalisation of the economy will require investment in the high-value skills, global connectivity and infrastructure which will attract businesses and people to live, work and visit this country.

Draft Scottish Budget

11. Scotland's public spending challenge is understood. While the total resources available to the Scottish Government are still set to rise, taking inflation into account, Total Managed Expenditure will fall by 0.7% or £243 million, from £34.9 billion to £34.6 billion. This is the first annual real terms fall since devolution.
12. The Scottish Government's Departmental Expenditure Limit faces a slightly larger reduction at 0.9% or a fall in spending of almost £265 million when compared to 2009-10 and £500 million from the 2007 Spending Review.
13. Tough choices need to be made within this envelope. The Scottish Government has stated that its purpose is higher sustainable economic growth and it is even more important that its decisions are based on this priority. Public spending will have to support the growth which generates the finance for frontline services. Long-term challenges and opportunities are even more important considerations for public spending.
14. The draft Scottish Budget includes a number of welcome commitments which will support the domestic economy and employment in the economic downturn. The Scottish Government is continuing to support the Small Business Bonus scheme, but clarity would be welcomed on whether it intends to introduce a transitional rate relief scheme as the UK Government is proposing to do. Extra funding of £24.5 million is being made available for Further Education institutions. Resource grants for local government are going up by over £400 million or 5.2%.
15. Overall however, we do not consider that the draft Scottish Budget displays this long-term prioritisation and the Finance and Sustainable Growth portfolio has suffered the largest absolute and percentage reduction, down by over £200 million or 7%.

Business Growth and Inward Investment

16. Scotland's enterprise networks, Scottish Enterprise and Highlands and Islands Enterprise, are the Scottish Government's main delivery agencies in addressing the key challenges for the Scottish economy which have been identified. Yet funding for Scottish Enterprise in 2010-11 has fallen from £295 million planned in last year's Scottish Budget to £201 million in this year's Draft Scottish Budget, and for Highlands and Islands Enterprise from £73 million to £54 million. SCDI understands that around £35 million of these differences can be explained by the acceleration of capital spend, but that still leaves a gap of nearly £80 million.

17. This compares to spending by the enterprise networks of nearly £600 million in 1997-98. This reduction partly reflects the Scottish Government's decisions on capital expenditure, the transfer of skills development and the business gateway. But it must be questioned whether, with economic growth projected to stay below the long-term trend rate, the allocation of funding to them should not be greater. Grant funding for Scottish Enterprise is barely more than for Concessionary Fares, which has increased by £2.5 million and has now reached £194 million.
18. Data indicates that every £1 million invested by Scottish Enterprise generates £5 million for the Scottish economy and one third of its delivery is through private sector partners. SCDI welcomes the expansion of the Scottish Manufacturing Advisory Service to double the number of companies it can reach. But its services are aimed at manufacturers which are already based in Scotland. The life sciences sector contributes £3 billion annually to the Scottish economy and it has been identified as a key industry, but the BioIndustry Association estimates that it is at least ten years from producing large-scale firms which are able to compete internationally. One challenge is the lack of venture capital investment in Scotland with which companies can undertake more advanced R&D and commercialise their products. This problem has been overcome in Ireland and Singapore through match-funding by public sector economic development agencies. However, budgetary constraints limit the ability of Scottish Enterprise to offer similar grants of over £5 million and ultimately this may undermine the competitiveness of the Scottish life sciences sector. A more fundamental review is needed of whether the proposed levels of funding for the enterprise networks are sufficient to play activist roles in rebalancing the Scottish economy and expanding the high-value manufacturing exports base through business growth and inward investment.

Low Carbon Economy

19. Exports of renewable energy technology, especially wave and tidal technologies, have been identified as a particular opportunity for the Scottish economy. SCDI welcomes confirmation by the Cabinet Secretary for Finance and Sustainable Growth John Swinney MSP that the renewable energy budget has increased to £32m in 2010-11, but it is unclear how this will be allocated and if it will be sufficient to fund the wide range initiatives which it is supposed to enable. SCDI supports the Scottish Government's call for Scotland's fossil fuel levy account to be released without reducing the Scottish Consolidated Fund and this should be used to develop low carbon energy projects. However, with or without it, the Scottish Government should provide sufficient funding for this priority sector.
20. The Crown Estate will announce the results of the Pentland Firth Round early next year and the Marine Energy Road Map has recommended that the Scottish Government should introduce a flexible WATES (Wave and Tidal Energy Support Scheme) style initiative as an open call with an increased budget to ensure the full and swift development of pre-commercial projects, and SCDI would expect a positive response from Ministers to this proposal.

21. The recent Climate Change Bill gave powers for the 'greening' of business rates, a real opportunity to support and incentivise businesses in meeting the rigorous targets to reduce Scotland's carbon impact. With the Scottish Parliament possessing full powers over business rates, this is one example of how business rates could be reformed to better reflect economic and environmental priorities with bold green stimulus measures at the heart of an economic recovery.

22. SCDI welcomes the introduction of carbon accounting in the draft Scottish Budget for the first time. This demonstrates a commitment to monitoring the impact of the Climate Change Action Plan and should incentivise organisations to implement Carbon Reduction Plans, with the potential to kick start a low carbon economy, if it is supported by public policy and sufficient financial assistance.

Higher Education

23. Scotland's universities have key roles in raising the levels of business birth rate and business R&D in Scotland, developing the new technologies and products - including low carbon - which Scotland needs to export, and supplying the high level skills which high-value manufacturers and service industries demand. They are also businesses in their own right, generating around £2 billion a year, spending more than £500 million a year on goods and services and employing around 34,000 people. Moreover, they support internationalisation and there are significant opportunities, especially in the emerging markets. There are currently over 27,000 international students in Scotland, representing about 12 per cent of the full-time total. This growing contribution to the economy was recognised by the Scottish Government with their identification as the seventh key sector.

24. SCDI is concerned that the draft Scottish Budget does not sufficiently fund Scotland's universities to support economic recovery. Figures released this week by UCAS, showed that the number of Scots being accepted by universities and colleges has risen by 5.3 per cent, from 27,511 to 28,979 in 2009, the biggest increase for a number of years. But there is a wider concern that the Scottish Government has not articulated how it will ensure the long-term competitiveness of Scottish higher education which will be needed to rebalance the economy. SCDI would also suggest that consideration should be given to how funding is distributed in order to promote innovation and maximise the economic impact of the higher and further education sectors.

Skills

25. SCDI welcomes the action by the Scottish Government following the Apprenticeship Summit in which it participated earlier this year. A particular priority to help maintain investment in training and development has been the delivery of workplace relevant skills and the uptake of Science, Technology, Engineering and Maths subjects. These are highly-valued by key industries such as the oil and gas sector. Consideration should also be given to offering support for this sector to provide student placements and internships and continue professional and career development beyond the age of 25, particularly in SMEs.

Tourism

26. The Scottish tourism industry is a key sector in its own right and can support the wider internationalisation of the Scottish economy. It has had a good year, helped by the weakness of sterling and the “Homecoming Scotland” initiative. Even so, the industry-led and Government endorsed target of increasing revenue by 50% by 2015 appears challenging. Improved connectivity, transformational new investment and internationally competitive spending on promoting Scotland are all required through partnership working by the private and public sectors.
27. However, Government funding for tourism would fall by around £2.5 million or 11.7 per cent as a result of the draft Scottish Budget in 2010-2011. Moreover, VisitScotland forecasts that its budget will be a lower by a total of about £5.5 million, with the loss of £2.7 million of funding for Homecoming Scotland 2009, £300,000 for capital programmes and about £1 million from revenue reduction. VisitScotland will undoubtedly seek to identify further efficiencies and it is planning to cut budgets including business engagement. But it is a concern that it may still face a deficit and that front-line services like marketing may be affected.
28. VisitScotland and Scotland’s major airports have worked closely together to attract inbound flights from leading airlines. VisitScotland has a number of partnerships in place, including a £1 million partnership with Continental over three-years and a £1 million partnership with easyJet, and BAA Scotland has highlighted that: “the ability of VisitScotland to leverage large scale partnerships with major airlines provides Scotland with a real competitive advantage when it comes to sustaining existing and winning new international and domestic routes.” The aviation industry is under serious pressure and has been reducing flights. BAA Scotland will invest over £20 million in its route development fund in 2010, to protect and grow many of the new services which have been secured over recent years. However, if VisitScotland is forced to reduce its spending on marketing, including its partnerships with airlines, this would put these services in danger and could reduce connectivity for Scotland’s businesses and tourism.
29. In view of these challenges and successes of the Government-funded route development fund, the Scottish Government should seek to identify a process by which to reinstate this support, subject to European legislation.
30. SCDI is also concerned that the proposed budget cutbacks at the enterprise networks and VisitScotland will impair their ability to attract transformational inward investment in new high-value developments and to support smaller scale investment in existing hotels, guest houses and visitor attractions in the current economic climate through the creation of a new tourism investment vehicle.

Capital Spending

31. Capital investment creates the competitive infrastructure and connectivity which is needed to attract inward investment in high-value manufacturing and services from multinational businesses, and people to live, work and visit this country.
32. The UK Government and Scottish Government have both accelerated capital expenditure in the past year to counter the collapse of private sector investment, a response called for and supported by the SCDI. By accelerating spending from 2010-11, the 2009-10 Scottish budget was boosted by an additional £295 million, which was on top of a £53 million acceleration to the 2008-09 capital allocation. This has mitigated some of the impact on the construction sector, though an estimated 8,500 jobs have still been lost this year, on top of the 20,000 last year.
33. While it was always understood that this would impact on subsequent budgets, the question has been how the books would be balanced. The most recent UK Budget outlines net investment intentions as a percentage of GDP and the expectation is for this to fall from 3.1% of GDP in 2009-10 to 1.3% in 2013-14. SCDI believes that the UK Government should reconsider. However, the Scottish Government appears to have the freedom to allocate what has been provided as Resource Departmental Expenditure to Capital Departmental Expenditure Limit.
34. Within the context of a 0.9% reduction in Total Managed Expenditure, the Scottish Government proposes to cut the Capital Departmental Limit by £625 million in real terms or 17%, compared to a 1.4% rise in Resource Departmental Expenditure Limit. Reductions in capital spending by Scottish Enterprise, Highlands and Islands Enterprise and VisitScotland have already been noted. Capital support for local government has been reduced by 18% or £189 million. With the end of the Town Centre Fund, regeneration spending falls by over 70%.
35. It is not clear why - with higher sustainable economic growth the Scottish Government's overarching purpose for the public sector - it has chosen to reduce capital support to protect revenue spending. For example, an economic downturn would logically make funding for regeneration an even higher priority. The construction industry has downsized by an estimated 15% in both turnover and number of employees over the last 12 months and cannot afford to continue to lose jobs and capacity at that rate. It is now looking to the Scottish Government to hold firm on its infrastructure investment programme and undertake an energy efficiency retrofit programme which would be a win-win for the economy and environment. The Scottish Government has the flexibility to transfer extra resources to capital spending. This would align with its purpose and competitively position the Scottish economy to take advantage of long-term global growth.
36. The recent Global Financial Services Index underlined the high importance which global business leaders attach to transport and airport connectivity in making investment decisions. The Glasgow Airport Rail Link (GARL) has been recognised by the successive Scottish administrations and in the National Planning Framework 2 as a nationally-significant project for Scotland's transport network and sustainable economic development over the next 30 years.

37. SCDI is therefore very disappointed by the Scottish Government's decision to cancel GARL and unclear how it judged against the rest of its spending that such a nationally-significant project should not proceed. In the short-term, the project would have created 1,300 jobs and supported economic activity. Once constructed, is estimated that GARL would have delivered £3.14 million per annum in tourism and leisure, cut congestion and emissions, and boosted the Scottish economy by £400 million. SCDI believes that the project should proceed and would be a long-term legacy from the Commonwealth Games in Glasgow in 2014. We are strongly of the view that it should not be shelved completely. This has been identified as a nationally-significant (rather than a prestige) project for economy and, with the preparatory work already done by the client and the industry, it should take its place in those projects within Scotland's strategic transport infrastructure programme which will be funded following future spending reviews.

38. While we continue to support the delivery of the GARL project, SCDI would welcome assurances that any saving from GARL will be used to maintain investment in transport budgets. SCDI does not support any reductions in the Transport Scotland budget, and our members would wish to see progress and investment on other much-needed transport infrastructure projects around Scotland; for instance, the Aberdeen Western Peripheral Route.

39. Infrastructure spending can be supported by reducing inefficiencies in the procurement process and by finding way of securing additional private capital. The Scottish Futures Trust needs to come forward with innovative solutions.

ICT

40. Research for Cisco by Oxford University's Said Business School and the University of Oviedo's Department of Applied Economics suggests that many European countries are falling behind world leaders in Asia in fibre connectivity. The researchers estimated that countries would need an average download speed of 11.25Mbps and an upload speed of 5Mbps in order to be comfortably placed for future applications. In response, Germany and France are adopting national broadband or wider digital strategies and committing public funds.

41. The creation of a low carbon economy should not only involve investment in public transport and green energy schemes but also include reducing the need for travel through the appropriate use of ICT. The European Commission has championed ICT as a key enabler in bringing down carbon emissions - greater use of flexible working and teleconferencing alone could save over 44 million tonnes of CO₂ emissions per year or 1.7% of Europe's entire carbon footprint.

42. The UK has been a world leader in DSL coverage and broadband penetration, but the research for Cisco listed the UK among the countries whose broadband is "meeting needs for today" and ranked it 25th in the broadband leadership index. The recently published Ofcom Communications Market Report showed that Scotland continues to lag behind the rest of the UK in broadband connections.

43. The UK Government states in *Digital Britain* that it believes the case is made for the desirability of next generation networks, with significantly higher broadband speeds, typically in excess of 20Mbit/s, being available to the large majority of the UK population. A report by Analysys Mason for the Broadband Stakeholder Group calculated that a UK-wide Fibre to the Cabinet (FTTC) network would cost £5.1 billion, with a nationwide Fibre to the Home (FTTH) costing up to £29 billion. The increasing momentum behind the commercially funded roll-out to cities including Glasgow and Edinburgh is welcome, but there is recognition that it is unlikely to extend to rural and remote areas. The UK Government has proposed to introduce a £0.50 monthly levy on all fixed lines to provide funding to support the deployment to over 90% of the UK, which SCDI strongly supports. But a report for Highlands and Islands Enterprise by Analysis Mason has estimated that significant public funding would be required to deliver this target before 2017 and to complete roll-out to all rural and remote areas. In comparison, Finland's aim is 99% of households and business with access to 100Mbit/s by 2015.
44. Higher investment by the Scottish government in an ICT infrastructure for the public sector could be a powerful enabler for international competitiveness and economic growth by allowing the establishment of a 21st century infrastructure that could benefit public and private sector alike, particularly Scotland's SMEs.

Scottish Water

45. The Scottish Government's Draft Budget has proposed that Scottish Water would retain borrowing powers roughly in line with those in the Water Industry Commission for Scotland's Draft Determination of water charges for 2010-15. However, the Foreword to the Draft Determination highlights that in future the Scottish Government may no longer be able to offer Scottish Water the full flexibility in the timing of its borrowing that was available in the last regulatory control period. If this is the case, using the Scottish Futures Trust as a vehicle for providing finance to Scottish Water or allowing Scottish Water to borrow commercially is recommended. Public investment in water infrastructure creates economic, social and environmental benefits and, under the existing model, it should continue to be a high priority for the public purse. SCDI considers that should this model prove unsustainable in funding the Scottish Government's objectives, within tightening public expenditure limits and economically and socially acceptable charges, other external funding streams should be explored. The focus in this debate should be how to support sustainable economic growth.

Long-Term Challenge

46. The Centre for Public Policy for Regions (CCPR) has said that the Scottish Budget for 2010-11 is only the start of a longer-term process of significant real cutbacks in public services. Professor David Bell of Stirling University believes that the Barnett Formula will to an extent protect spending compared to programmes in England by reducing the block grant by Scotland's 8.4 per cent

population share rather than its 10.3% per cent funding share. But the CPPR has projected that spending will still be nearly 9% lower in 2013-14 than in 2009-10.

47. Long-term challenges which the Scottish Government faces which will require significant extra spending are climate change and Scotland's ageing population. The latest projections from the General Register's Office for Scotland are that the number of pensioners is expected to rise by 31% from 1.02 million last year to 1.34 million in 2033, and the number of over-75s is predicted to increase by 84% from 390,000 to 720,000. This will increase the ratio of dependent people - either those aged under 16 years of age or those over the pensionable age - to the working-age population from 60 per 100 at present to 68 per 100 in 2033. This will put further pressures on a range of Government spending programmes.
48. SCDI welcomes the debate on the benefits of the Scottish Government borrowing powers, but this should not delay or deflect the tough choices which will need to be made on public spending programmes. In the draft Scottish Budget, the Scottish Government has, broadly, prioritised protecting frontline services over investment for the future. SCDI believes that if Scotland is to meet the sustainable economic growth challenges ahead and create the wealth for frontline services, investment will have to be protected. This will necessitate greater consideration in forthcoming budgets of which revenue programmes are sustainable priorities, and how they can be redesigned, for example by using ICT or new delivery models, to provide high-quality and affordable frontline services.
49. Examination of working practices and increased investment in flexible working could provide significant savings in property and improvements in productivity that will help achieve the efficiency targets and free up resources to redeploy into priority frontline services. Private sector experience has shown that property savings of up to 35% can be achieved through the introduction of flexible working. This is dependent on high-quality, accessible and affordable broadband.
50. In conclusion, SCDI recognises tough choices must be made in terms of public spending commitments within the draft budget proposals and welcomes the opportunity to participate in the consultation process. However, SCDI considers further review of the proposals is required to deliver an investment-consumption balance which can deliver sustainable economic prosperity for Scotland,

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