



Scottish Council for
Development and Industry

POLICY SUBMISSION

DRAFT BUDGET 2012-13 AND SCOTTISH SPENDING REVIEW

October 2011

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.

For more information on this response please contact the SCDI Policy Team at

1 Cadogan Square
Cadogan Street
Glasgow
G2 7HF

e gareth.williams@scdi.org.uk

t 0141 222 9726

Draft Budget 2012-13 and Scottish Spending Review

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.

Economic Outlook

2. The outlook for the Scottish economy is highly uncertain. Economic output has not yet returned to pre-recession levels and, while the Scottish economy has demonstrated resilience, economic growth has been slowing again and there is a risk of a double-dip. The Eurozone crisis is not resolved and defaults could trigger a downturn in our largest export market and a further global credit crunch. A significant weakening of the euro against the pound would have a negative impact on exports and tourism. Scottish consumer and business confidence is already weak and very fragile. All sectors of the Scottish economy would be affected including engineering, oil and gas, food and drink, and renewables, which have been performing strongly.
3. In the last year, the Scottish labour market has performed relatively well compared to the UK as a whole, but, in common with the rest of UK, there is particular concern about the rising levels and the long-term implications of youth and long-term unemployment.
4. Over the period of the Spending Review, there will be significant real terms reductions in public spending in Scotland brought about by the UK Government's deficit reduction strategy. HM Treasury has made it absolutely clear that it is committed to this strategy and that it considers that there is no room for flexibility. It is anticipated that this will reduce demand within the Scottish economy, given that the public sector is a major employer and purchaser of private sector goods and services. Private sector growth will therefore be essential to overall recovery and growth in the Scottish economy and in the labour market. Energy (oil and gas, and low carbon), higher exports and tourism are likely to be the greatest sources of replacement demand as public sector funding is reduced. The key challenge for Scotland and the UK remains to rebalance the economy from consumption to investment and higher net exports.

Budget Priorities

5. SCDI welcomes the statement that "the decisions taken within this Budget have been shaped by the Scottish Government's Purpose of creating a more successful country, with opportunities for all of Scotland to flourish, through increasing sustainable economic growth". Scotland's long-term economic growth rate has been sluggish and lower than the UK as a whole and other small European countries, and while Scotland's employment performance, in

recent times, has been comparatively strong in a UK context, the latest data suggests that the gaps between annual Scottish and UK GDP growth rates still exists. With some economists suggesting that the “new normal” for the UK economy may be GDP growth of less than 1%, evidence from other developed countries and from history of the risks of long-term economic stagnation, and the need to create employment opportunities, especially for Scotland’s young people, focus on this Purpose – as the Scottish Government states – is even more crucial. SCDI believes that, while a range of measures should be developed and considered, the Scottish Government is absolutely right that this Purpose must remain central to the Government Economic Strategy and National Performance Framework. With the recession and slow recovery having played havoc with GDP growth and employment rates the case is even stronger for medium term pathways and targets against which progress can be measured and changes guided to policies should it become apparent that Scotland is not on track towards the 2017 targets.

6. Analysis of successive Scottish Budgets does not provide strong evidence that this imperative was and has since been at the heart of Spending Review processes. Economy, Energy and Tourism have often been relative losers. Spending in other areas, such as education or health, has not obviously been re-aligned with delivering the stated long-term Purpose of increasing sustainable economic growth. A key decision of this Spending Review – to ring-fence health spending and the impact that this has on other areas that are vital to sustainable economic growth and wellbeing – again raises questions about whether increasing sustainable economic growth is the spending priority of the Scottish Government, and whether opportunities to look at shared services, integration and smarter working, and at private, public and voluntary sector partnerships, have been sufficiently explored and employed. SCDI believes that all spending programmes should have been realistically re-evaluated and decisions based on an analysis of their long-term contribution to Scotland’s sustainable economic growth and wellbeing, as defined in the National Performance Framework.
7. SCDI does welcome evidence that sustainable economic growth has been a higher priority in this Spending Review than in previous Budgets - such as the commitment to capital investment - which is identified later in this submission.
8. With public sector budgets under pressure, delivery needs to become consistently world-class. Along with the Spending Review, the Scottish Government published its response to the Christie Commission on *The Future of Delivery Public Services*. In relation to benchmarking, the Scottish Government has said that it will introduce benchmarking performance across public services. However, SCDI believes that Scotland should develop benchmarking between our public services and the best internationally. The Christie Commission found that “the potential benefits of Scotland’s National Performance Framework and local Single Outcome Agreements are far from being fully realised and they need to become outward-facing... [and] much

more closely involve the private sector, civic organisations and communities in developing and delivering outcomes, and more clearly influence spending and other public sector decisions". SCDI agrees and hopes that national and local government and their public sector partners will redress these points. SCDI welcomes the Scottish Government's acceptance of the recommendations on preventative spending. It is less clear whether and how it intends to implement the recommendations that shared services and collaboration should become the norm and that contributions to public service delivery from the third and private sectors are underdeveloped and there should be 'competitive neutrality' between suppliers.

9. The Christie Commission found that procurement is often taken forward on a scale that discriminates against small providers and that there should be a rebalancing from efficiency to effectiveness. SCDI welcomes the Scottish Government's willingness to press for changes to European regulations. SCDI also supports its plan to use public procurement as a lever for job creation by ensuring that major public contracts deliver new training and apprenticeship opportunities. However, such pre-requisites are not appropriate for small and micro businesses which are bidding for contract or subcontract opportunities.
10. While the Scottish Government has protected local government to a greater extent than the UK Government, Scottish local government faces significant real terms reductions in spending along with rising levels of demand for services. SCDI is very concerned that, given the statutory responsibilities on local authorities in other areas, local economic development will again be squeezed. Closer involvement of the private sector in Community Planning Partnerships and Single Outcome Agreements would help to align spending and other decisions with the needs of the economy. However, it would also be worth considering whether to amend the statutory framework to include a duty for local authorities and all public bodies to focus on increasing sustainable economic growth.
11. SCDI has also proposed that a small proportion of the public procurement budget should be ring-fenced to stimulate innovation across the Scottish economy. Ring-fencing only 0.5% of the £8bn per annum budget would boost funding by £40m.
12. SCDI has previously raised concerns that budgetary pressures, demographic changes and future projections of the falling ratio of the working age population to their dependants raises questions about the fiscal and economic sustainability or scope of certain universal entitlements among the larger range of universal benefits which the Scottish Government has committed itself to since devolution. These issues were identified in both the Beveridge and Christie reports, with the latter calling for an open and transparent debate. These entitlements have since been incorporated into the refreshed Government Economic Strategy, without any supporting evidence on their economic benefits, and SCDI is not convinced that this is appropriate for a

strategy for increasing long-term sustainable economic growth. To facilitate an informed debate, SCDI believes that the Scottish Government should publish a discussion paper on universal benefits which includes what it quantifies as their contributions to sustainable economic growth and other outcomes, projects increases in costs and their share of the overall Scottish Budget, and identifies the efficiencies of universal provision rather than a more targeted approach and any savings to the schemes which might be realised by restricting the benefits e.g. removing free bus passes from those working or raising the age for free bus passes as the retirement age rises.

13. SCDI believes that there is scope for a greater role for user charging - as is common in other countries - but this is not developed in the Spending Review.

Enterprise Agencies and VisitScotland

14. In overall terms, the budgets for the enterprise agencies are a reasonable outcome. However, the fact that a large proportion of the budget shifted from resource to capital will be in the enterprise budget will reduce the economic benefit of this decision. This will represent more than 29 per cent of the enterprise agencies' budget over the Spending Review period. SCDI agrees that there are major infrastructure requirements and opportunities, for instance in the low carbon energy and digital sectors, but it is concerned that this transfer can only significantly reduce the funding available to support growth businesses, exporting and, for key businesses which are struggling in the current economic climate, diversification.
15. Supporting supply chain clustering and their understanding of how they can better collaborate around market opportunities will be vital roles for the enterprise networks. The National Renewable Infrastructure Plan is a good example of a roadmap for investment in potentially the sector with greatest growth potential, but there would be value to developing equivalent plans for other priority sectors.
16. More effective commercialisation of Scotland's world-class research base is a priority. There is a need to refocus innovation schemes and the Scottish Government's plan to streamline investment in innovation and commercialisation to better align support to businesses and universities is welcome. SCDI has proposed that one Office of Higher Education Technology Transfer is created.
17. Rationalisation and a significant reduction in the resources available continue to offer Scottish Enterprise, in particular, the opportunity to improve its partnering. The enterprise networks should regard partnerships with external organisations as multipliers and actively seek new opportunities to outsource and act as a commissioner, catalyst and enabler rather than the main deliverer of services.

18. The key role of cities within the national enterprise agency network also needs to be recognised and the current priority sector based approach to business support, investment and development overlaid with city growth opportunities and requirements ensuring that the Scottish Government both maximises and supports the investments currently being made by the cities themselves in economic development, business growth and support.
19. We welcome the continued support of the Scottish Government to growing Scottish tourism and recognising the contribution it makes to the Scottish economy at both a national and local level. The Scottish tourism sector has a key role to play in both creating and sustaining jobs and in attracting major inward international inward investment, such as the Trump International Golf Links. Encouraging closer industry collaboration and promoting more general excellence will be important. The impact of spending decisions on tourism must be considered in relation to infrastructure, air route connectivity and broadband all of which are critical to ensure that Scotland continues to grow and support earnings from tourism, including conventions, business tourism and major events.

Low Carbon Economy

20. As previously stated, the low carbon economy could be one of the greatest sources of replacement demand. SCDI welcomes the significantly increased low carbon energy budgets for Scottish Enterprise and Highlands and Islands Enterprise. The Scottish Government can pump-prime this sector, but the vast majority of the investment will be private. Planning policy for development, demonstration and deployment projects and associated infrastructure is a key. Therefore the reduction of the central planning budget by £1m, or a fifth of its budget, raises concerns about whether spending decisions are being joined-up, especially if local authorities make similar reductions in their planning budgets.
21. SCDI is concerned about the rising costs of energy and its economic and social consequences. Consideration of the costs of renewable energy and its impact on fuel poverty should take into account the rising costs of carbon and climate change. The provision of community and household renewable schemes, alongside measures to improve efficiency and reduce consumption, offers the opportunity to tackle fuel poverty today and in the long term. Energy suppliers have recognised that they an increasingly important role to play.

Exports

22. SCDI proposed that the Scottish Government establish an ambitious target to grow Scotland's exports and welcomes the Scottish Government's announcement of a target to deliver a 50 per cent increase in exports by 2017. We welcome its plans to look to strengthen trade support particularly in Scottish Development International's Overseas Trade and Investment Centres. We propose that there are also significant opportunities to work with

Scotland's private sector to extend this network at no cost by utilising their overseas offices to establish a complementary network of Scottish Trade Centres in key locations offering in-kind office spaces and meeting facilities for Scottish SMEs. We also support the plans to use the loan and equity finance provided through the Scottish Investment Bank's Scottish Co-Investment Fund and Scottish Loan Fund to address the demand for risk capital by companies with the greatest opportunity for sustained growth and exports, and the new Export Support Initiative to accelerate the international development of at least 100 companies.

23. SCDI understands that the Scottish Government hopes to be able to vary Air Passenger Duty, should it be devolved, to maintain and attract new routes. But given the need for global connectivity and the challenges in the aviation industry, SCDI is disappointed that no provision appears to be made to reintroduce an Air Route Development Fund, should it be approved by the European Commission.

Non-Domestic Rates

24. SCDI's priority for non-domestic rates has long been that the poundage rate in Scotland should be no higher than the rate in England. The Scottish Government is committed to this over the spending review period and this is welcome. SCDI understands that the growth in Non Domestic Rates income is based on the impact of matching the English poundage rate through the application of the Office of Budget Responsibility's most recent estimate of RPI inflation between 2012 and 2015, estimates of economic growth and the settlement of appeals later in the revaluation cycle. SCDI is content that the Scottish Government's budgeting is consistent with those of the UK Government and previous revaluation cycles. If the UK Government takes a different approach to the English poundage rate, economic growth is lower and/ or successful appeal levels very high, this may, of course, result in lower than forecast income. In those circumstances the Scottish Government should maintain equalisation of the poundage rate and should not seek to make up any shortfall from business. Affordability is a key issue at this time.
25. SCDI is concerned that the proposed significant reduction in empty property relief will in the current weak property market delay the return to viability for speculative development, setback the ability of the development sector to award much needed construction contracts and, perversely, require developers to seek larger subsidies from the public sector. It is acknowledged that the intention is to retain a competitive advantage in the relief available over England, but the experience in England has been that vacancy rates have increased since the relief was reduced and the anticipated substantial revenue savings have not been achieved. Making provision for empty rates is an additional cost of development. Owners of vacant properties do not, generally, keep property intentionally vacant and the imposition of vacant rates will do nothing to encourage an owner to enter into a lease. The problem is lack of tenant demand more than the level of rent that a tenant is

willing to pay. Existing tenants seeking to assign or sub-lease will usually be constrained by the alienation provisions of the lease and have no ability to accept a rent lower than passing. SCDI is concerned that a number of further consequences have not been considered:

- Valuers will reflect to cost of empty rates on vacant or short term let properties. This will reduce values and could have the effect of creating a loan to value breach with a lender putting more pressure on borrowers and lenders alike
- Given the floorspace reduction targets announced in the Asset Management Plans for the public sector estate much of any burden might fall back on the public purse
- Assisted areas benefit from BPPRA, a UK tax allowance designed to encourage bringing vacant property back into use. Imposing empty rates will be at odds with such a policy

26. Legislation will be required to reform empty property relief. SCDI accepts that there is a need for a more responsible approach to value and reform of empty property relief may be a part of this process. However, these reforms should also protect rather than setback economic recovery. It is important that the Scottish Government consults with the industry and others, and is prepared to make changes to its plans to reflect the state of the market and address the concerns.

27. SCDI is strongly supportive of increased preventative spending. It recognises that difficult decisions were required on both sides of the tax and spend equation, and that further action is needed to tackle the costs, not least economic, of alcohol and tobacco misuse. However, it was very disappointed by the complete lack of consultation by the Scottish Government in relation to its proposed public health levy on large retailers of both tobacco and alcohol, and the absence of an associated Business and Regulatory Assessment. The levy will only affect large retailers and it therefore does not relate fairly and proportionately to the particular social impact of tobacco and alcohol sales by all retailers. Investment by the large retail sector is needed to support economic recovery and employment opportunities, especially for young people, and the margins of stores are not large. Such a surprise announcement is a disincentive to investment, creates uncertainty and damages business confidence. Further details are needed on how the levy will operate - including whether it would still be applied to retailers which respond by ceasing tobacco sales in their stores, which, presumably, the Scottish Government would welcome - and on how the funding raised will be invested in preventative spending. SCDI believes that the Scottish Government should now provide long-term certainty for all retailers and make clear that it will not increase or extend the levy further over the term of the current Parliament.

28. Given our broad private, public and third sector membership, SCDI convened a series of annual meetings between the Minister of Finance, civil servants and representatives from business, trade organisations, local authorities and trade unions prior to announcements on non-domestic rates between 2000 and 2006. The meetings were opportunities to discuss evidence from business and other organisations on the impact of the Scottish Executive's policy, revaluations and other relevant matters, to inform subsequent decisions. With the announcement of a firm timetable to re-equalise the poundage rate in Scotland, they were ended. However, following the decisions in the recent Budget, there is now a strong sense that the opportunities for input and the provision of evidence in advance of decisions are not sufficient, and SCDI has suggested to the Scottish Government that it is prepared to convene and independently chair the meetings.
29. SCDI understands that the Scottish Government will conduct a review of non-domestic rates before the next revaluation cycle and believes that it will be important to take a strategic approach involving all sectors of the economy.

Skills

30. Scotland's total public and private investment in higher education as a percentage of GDP, at around, 1% is lower than the sector's main competitors, and SCDI was concerned that the cuts in UK public funding could reduce this proportion even further, at a time when others are investing more heavily. This would have had implications for businesses' confidence in the skills levels of Scotland's future workforce and on research and development excellence. The Spending Review appears to maintain Scottish funding levels vis-à-vis England and this is welcome. SCDI remains concerned about whether the funding model for Scottish universities will be able to sustain the increases in investment in universities which were identified in the *New Horizons* report, that by 2028, Scotland should be in the top quartile of OECD countries for investment in universities. SCDI supports the objective of more closely aligning higher education with the economic priorities and the needs of Scottish businesses. It suggests that outcomes for higher education should be agreed to measure the competitiveness of its funding and its performance. These might include:
- Increase the percentage of the Scottish workforce qualified to higher education levels to the levels of competitors such as Norway, the USA and the Netherlands (Source: OECD)
 - Maintain the current world-leading position of Scotland's research in the global top three for citations relative to GDP and impact as measured by citations per paper, and in the global top five for impact of the most-highly cited research (Source: International Comparative Performance of Scotland's Research Base)
 - Further increase the percentage of all research submissions by Scotland's universities to be "world-leading" (Source: Research Assessment Exercise)

- Maintain at least one Scottish university in the world's top 50 and a further four in the top 200 (Source: The Times' Higher Education World University Rankings)
 - Increase the annum of income to Scotland from fee-paying international students
31. SCDI is concerned about the substantial reduction in the further education budget. College budgets have increased substantially in recent years. With businesses, especially in growth sectors, still reporting concerns about whether skills supply is being aligned with demand in all parts of the country, SCDI agrees that it is right to consider the efficiency and effectiveness of spending. SCDI is aware of many examples of strong alignment between colleges and businesses. However, there are also recent instances of where the current model of delivery does not support industry growth and individual opportunities, such as through skills transfer, because the costs of delivery through a college are significantly higher than necessary and are affordable for the public sector and businesses.
32. These are issues which will be considered in the Scottish Government's review of post-16 education and it would have been preferable if the further education budget had been settled following rather than in advance of its conclusions. SCDI believes that this should identify and agree outcomes for the sector, including its key role in achieving the *Opportunities for All* commitment to give a guarantee of a place in education or training to every young person aged 16-19 if they are not currently in education, training or employment. Funding and structures should then be aligned with these outcomes, and if it is concluded that the further education budget requires further funding, it must be a high priority in future Scottish Budgets where there is any flexibility or additional budget consequentials are made available as a result of the UK Government Budgets.

Capital Investment

33. SCDI strongly supports the decision to shift some £200m per annum in revenue spend to capital. This should be kept under review and it should be raised if required to deliver the capital programme. The Office of Budgetary Responsibility has said that boosting capital spending is one of the most effective ways of boosting GDP with a multiplier of one-for-one ie an increase in government investment of 1% of GDP is estimated to boost GDP by 1%. SCDI has called for the Scotland Bill to be amended to increase the Scottish Government's ability to borrow for capital investment. It also considers that there is scope for the Scottish Government to develop alternative funding models.
34. SCDI believes that the Scottish Government is right to continue to develop infrastructure improvements which will enhance Scotland's GDP in the long-term and maintain and increase business confidence in Scotland as a location

for investment, and we are broadly supportive of its investment priorities. We have recommended a review of the capital investment programme to establish whether there should be any re-prioritising in the current economic climate.

35. We welcome the Scottish Government's commitment to deliver 30,000 new affordable homes over the Parliament and the benefits of this construction for local economies. The impact on fuel poverty of the reduction in spending on social housing investment could, to extent, be offset by investment in energy efficiency and insulation measures for the existing housing stock.
36. SCDI is very disappointed by the decision to end the Freight Facilities Grants. The Scottish Government's Report on Policies and proposals recognises the role of investment in modal shift from road to rail. Given the time they take to deliver, the Scottish Government's decision earlier this year to extend the grants for only a year was insufficient to develop projects. Opportunities have been identified in sectors such as whisky, but government pump-priming will probably be needed. SCDI therefore hopes that Future Transport Fund, planned to be introduced in 2012-13, will include funding which replaces the Freight Facilities Grants.
37. SCDI is concerned by the Scottish Government's decision to only partially restore Scottish Water's previously agreed capital funding, which will remain 20% short of the earlier Scottish Government commitment. Investment in water infrastructure is a key enabler for sustainable economic growth and environmental improvements, and supports the civil engineering sector. The Scottish Government has also announced proposals for Scottish Water to diversify into renewable energy and for Scotland to become a "hydro nation".
38. SCDI recognises that a slower rate of economic growth may mean that lower investment is needed in new infrastructure and that Scottish Water has demonstrated that it can achieve significant efficiencies. However, the Scottish Government has acknowledged that its decision presents risks and may need to be reviewed. SCDI is concerned that this reduction in capital funding may affect the capacity of Scottish Water and its supply chain to deliver infrastructure needed to enable sustainable development when the economy recovers. SCDI believes that the necessary investment must be available. This must be kept under review and if capital funding needs to be increased and the Scottish Government is unable to provide it, alternative sources must be considered.
39. SCDI strongly supports the Scottish Government's priority of delivering the ambition of next generation broadband to all by 2020, with significant progress by 2015. Private sector investment will deliver this to the majority of the population, but partnerships with the public sector will be needed, mainly in rural and remote areas. Funding of £68.8m has been secured from the UK Government and the Scottish Government also plans to introduce a Next Generation Digital Fund. However, SCDI is concerned that this level of public

funding may be insufficient to achieve the ambition and looks forward to the roll-out strategy early next year.

40. SCDI has been working with Scotland's six cities and the Scottish Government to develop the cities agenda. We welcome recognition in the Spending Review that the cities are central to Scotland's economic recovery and key drivers for growth, and the Scottish Government's commitment to innovative sources of finance. SCDI supports the piloting of Tax Increment Financing projects, including the provisionally approved business case for Edinburgh Waterfront Development, and the proposals for Buchanan Galleries in Glasgow and Aberdeen City Centre.

Gareth Williams
Head of Policy
Scottish Council for Development and Industry