DATA LABEL: PUBLIC

West Lothian Council

PARTNERSHIP AND RESOURCES POLICY DEVELOPMENT AND SCRUTINY PANEL

HORIZON SCAN

REPORT BY HEAD OF FINANCE AND PROPERTY SERVICES AND HEAD OF PLANNING, ECONOMIC DEVELOPMENT AND REGENERATION

A. PURPOSE OF REPORT

The purpose of this report is to provide the Panel with:

1. A summary of the latest UK economic indicators and announcements, including the potential implications following the referendum vote to leave the European Union (EU);
2. An update on the estimated revenue budget position facing the council as a result of ongoing unavoidable spending pressures and government funding constraints, including highlighting budget model risks and uncertainties.

B. RECOMMENDATIONS

It is recommended that the Panel notes:

1. The latest economic and financial position and the potential financial implications for West Lothian and the council's future financial planning;
2. That whilst the council's estimated budget gap for the five years 2018/19 to 2022/23 continues to be £65.3 million, this will change as a result of the finance settlement in December and detailed review of the budget model currently being undertaken;
3. The specific risks which could have an adverse impact on the overall financial plan and the detailed revenue budget agreed for 2019/20;
4. The potential risks and uncertainties in the five year revenue budget strategy;

C. SUMMARY OF IMPLICATIONS

I.	**Council Values**	Being honest, open and accountable, focusing on our customers' needs, making the best use of our resources, working in partnership
II.	**Policy and Legal (including Strategic Environmental Assessment, Equality Issues, Health or Risk Assessment)**	The council is required to approve a balanced revenue budget for each financial year. Audit Scotland and CIPFA best practice guidance recommends medium term financial plans are prepared for at least five years. Leaving EU membership could have significant implications for West Lothian, the local economy, communities and the council.
III.	**Implications for Scheme of Delegations to Officers**	No implications at this stage.
IV.	**Impact on performance and performance indicators**	The current EU programmes to 2020 support business development, community regeneration and employment projects. Ongoing government restraint has implications for the council's budget and performance.

V.	**Relevance to Single Outcome Agreement**	The revenue budget provides the resources necessary to help deliver the Single Outcome Agreement. Effective prioritisation of resources is essential to achieving key outcomes.
VI.	**Resources (Financial, Staffing and Property)**	Scottish Government grant funding is not sufficient to meet increasing costs and demand for services. Based on agreed budget assumptions, the council faces a revenue budget gap of £65.3 million over the five year period. West Lothian Council agreed budget savings of £60.1 million, leaving a balance to be found of £5.2 million.
VII.	**Consideration at PDSP**	None.
VIII.	**Other consultations**	Heads of Service and Depute Chief Executives.

D. TERMS OF REPORT

D.1 BACKGROUND

Horizon scan and budget model updates are provided to the Partnership and Resources Policy Development and Scrutiny Panel (PDSP) on a quarterly basis, including the latest information on the UK, Scottish, West Lothian and council economic position, and the potential impact on the council's medium term financial strategy. On 13 February 2018, Council agreed the five year priority based revenue budget strategy, noting an estimated budget gap of £65.3 million. Council also approved savings of £60 million and agreed a number of areas for officers to consider for additional potential savings.

The report includes the latest update on economic factors that could have an influence on the council's financial strategy. The report also provides an update on the council's approved revenue financial plan for the period as well as setting out the budget model risks and uncertainties.

D.2 HORIZON SCAN – UK

EU Implications

The UK formally triggered Article 50 on 29 March 2017, giving two years notice of the UK's withdrawal from the EU, meaning that the UK would cease to be a member of the EU from 29 March 2019. In March 2018 EU leaders approved guidelines for the negotiation of future relations with the UK after Brexit and also agreed a 21 month transition period to the end of 2020 if a deal on the relationship is reached before the exit date in 2019. In addition EU state aid and procurement rules will continue to be in effect until at least 2021.

The draft withdrawal agreement, agreed by the EU negotiators and the UK Government cabinet, was published on 14 November 2018. The agreement incorporates the financial payment from the UK to the EU, the 21 month transition period and commitments on the rights of EU and UK citizens. It also includes a "backstop" arrangement regarding the application of EU rules in Northern Ireland, arrangements between Northern Ireland and the rest of the UK and creation of a temporary single custom territory.

The agreement has to be considered by the UK parliament and the other 27 EU member states and, until matters are concluded, there continues to be ongoing uncertainty at all levels and within all sectors of the economy. It is still possible that the negotiations, and the resulting draft withdrawal agreement, may not result in agreement meaning the UK could potentially leave the EU without a deal. The transition period agreed in March 2018 is conditional on a deal being finalised. If no deal is agreed, World Trade Organisation rules will apply to trade between the UK and EU which potentially would have major implications for imports and exports and could provide a shock to the economy.

UK Economic Update

Debt and Borrowing

The most recent forecast from the Office for Budget Responsibility (OBR) on 29 October 2018 provided updated borrowing forecasts. Public Sector Net Debt is expected to fall from 85.0% of GDP in 2017/18 to 83.7% of GDP in 2018/19 before gradually falling to 74.1% in 2023/24.

Borrowing has also fallen more than anticipated in the first half of 2018/19, relative to the same period last year. This reflects stronger tax revenues and lower than expected spending on welfare and debt interest. Although borrowing has reduced, debt as a percentage of GDP is reducing at a slower rate than historical precedents. In addition, the Chancellor's policy and spending announcements in the Autumn Budget 2018 will mean that the additional tax receipts have not accelerated the reduction in the debt deficit.

Economic Growth

In October 2018, the International Monetary Fund (IMF) published its World Economic Outlook Update. Growth projections have been revised down for the UK with the IMF expecting growth to slow from 1.7% in 2017 to 1.4% in 2018. Business investment is expected to remain weak in light of uncertainty about Brexit.

In November 2018, the Bank of England maintained its 2018 growth forecast at 1.5% whilst reducing their 2019 forecast by 0.1% to 1.7%. The Office for National Statistics (ONS) released economic growth figures on 28 September 2018 with growth improving in the third quarter. Growth in the latest quarter was driven by the services sector, which increased by 0.6%, due partly to an increase in retail sales. The economy grew by 0.6% in quarter three of 2018, compared to 0.4% in quarter two and 0.2% in quarter one.

The economic outlook will depend significantly on how the EU withdrawal is practically implemented. Commentators expect the UK economy to experience tepid growth in 2018 due to higher inflation, reduced consumer spending and a loss of momentum in the Eurozone economy. In addition most commentators have assumed that the EU and UK will sign a withdrawal agreement and forecasts could be revised downwards if no stable transition is agreed. If growth in 2018 is in line with the forecasts above, this will be the weakest performance since 2012 and will be substantially below the post war norm of 2.4%. UK GDP growth is currently the lowest in the G7 with commentators assessing the growth as poor by historical, national and cyclical standards. With no anticipated improvement in productivity in the short to medium term it is expected that low growth will continue for the next three years as a minimum.

Exports and Inward Investment

In the immediate wake of the referendum, sterling fell sharply to a 31 year low versus the dollar, and was down about 6% against the euro. A weak pound makes the goods that the UK buys from abroad more expensive, pushing up the cost of living, but can also help support exports. The pound has been making a very slow recovery against the dollar and, on 22 November 2018, the pound was $1.28 against the dollar and €1.12 against the euro.

The British Chamber of Commerce (BCC) published its Quarterly Economic Survey in October 2018 which suggests that this year's annual economic growth is set to be the lowest since the financial crisis. The slowdown in manufacturing exports and many services businesses not employing new staff are is identified as causes for concern.

Inflation

UK inflation, as measured by the Consumer Prices Index (CPI), was 2.4% in the year to October 2018 In the Autumn Budget 2018 announced in October, inflation is forecast to be above target for 2018 whilst quickly returning to the 2% target thereafter.

Interest Rates

The Bank of England Monetary Policy Committee (MPC) agreed on 31 October 2018 to maintain the Bank Rate at 0.75%. The MPC judged that the current stance of monetary policy remained appropriate and that, were the economy to continue to develop in line with the November Inflation projections, an ongoing tightening of monetary policy would be appropriate to return inflation sustainably to the 2% target. Any future Bank Rate increases are likely to be at a gradual pace and to a limited extent.

Unemployment

The latest figures published on 16 October 2018 show that, over the period June 2018 to August 2018 the UK unemployment rate was 4.0%. There were 32.39 million people in work, 289,000 more than the previous year, giving an employment rate of 75.5%.

House Prices and Consumer Sentiment

The latest ONS House Price Index published on 17 October 2018 showed that, in the year to August 2018, average house prices in the UK increased by 3.2%. Over the past two years, there has been a slowing in UK house price growth, driven mainly by a slowdown in the south and east of England.

Consumer sales have improved during quarter 2, however the household saving ratio reached a record low in 2017 and is continuing to decline. The household savings ratio is at its lowest since records began in 1963 and, with reduced savings, the scope for consumption to be supported through consumers saving less is more limited. This is further compounded by stagnant wages growth, with household disposable income remaining considerably below the 1990s average of 3.1%, at only 1.3% in 2018.

Autumn Budget 2018 and UK Medium Term Outlook

The Chancellor of Exchequer delivered his Autumn Budget 2018 to the House of Commons on 29 October 2018. This is the last budget before the UK is due to leave the European Union in March 2019, however the Chancellor did state that the 2019 Spring Statement could be upgraded to a full budget if required. In summary, the key economic announcements were:

- Current and future UK tax revenues are expected to be higher than previously forecast.
- In line with the Spring Statement, the UK economy is expected to continue to grow every year, however GDP growth continues to be low.
- Public borrowing in 2018 is lower than forecast in the 2018 Spring Statement.
- Inflation is forecast to be above target in 2018 thereafter quickly returning to 2%.
- The OBR also anticipates that the labour market will slowly grow over the period increasing the forecast employment rates.

The Autumn Budget included a number of spending commitments, funded through increased UK tax revenues, which means that public services resource spending has improved with it now rising rather than falling post 2018/19.

As noted in the Spring Statement 2018, the UK Government will provide detailed spending plans for 2020 and beyond in a spending review scheduled for 2019. It was expected that the Autumn Budget 2018 would set the spending envelope for beyond 2019, however this was not provided. There is no clarity on when this overall spending envelope will be announced however the Chancellor did make a commitment of annual average growth of 1.2% in departmental spending budgets. Based on the NHS commitment, it is likely that the majority of that increase will be directed to health. It is expected that this increase will feed through to the Scottish block grant, however given the commitment to health, it is unlikely that non protected areas will see real terms increases in budget.

D.3 HORIZON SCAN – SCOTLAND

EU Implications

The Scottish economy is likely to be affected by Brexit in a similar way to that of the UK in general terms, however changes to the tax system now mean that Scotland's own economic performance will have a more direct impact on the Scottish Budget.

Scottish Economic Update

Economic Growth

The Scottish economy grew by 0.2% in quarter 1 of 2018 and 0.5% in quarter 2. This growth was marginally better than the UK as a whole, and is at the fastest level since 2015, however it is still substantially below the long term trend and the gap in the growth per head between Scotland and the UK has widened since 2014.

Unemployment

The latest Labour Market Briefing, published in October 2018, showed that in quarter 2 2018, the unemployment rate was 3.9%, with 106,000 people unemployed. The rate of employment is 74.9% with earnings forecast to continue to be behind overall UK levels.

2019/20 Scottish Budget and Longer Term Financial Outlook

On 8 November 2018 the Fraser of Allander Institute (FAI) published their Scotland's Budget Report 2018. This publication incorporates the outcome of the Chancellor of the Exchequer's Autumn Budget 2018, along with the FAI's assessment of the potential future financial outlook for the Scottish Government and Scottish public services.

As a consequence of the spending commitments in the Autumn Budget 2018, the Scottish Government will receive an additional £950 million of Barnett Consequentials by 2020/21. The majority of this increase, £550 million, relates to health with much of the remainder arising from increases in local government spend in England. The Scottish resource block grant will increase marginally in real terms in 2019/20 compared to 2018/19. Block grant funding of £30.5 billion in 2019/20 is £552 million higher than 2018/19.

The FAI's analysis shows that the outlook has improved since the last Scottish Budget, however it is likely that some of the uplift will be offset by weak income tax forecasts from the Scottish Fiscal Commission (SFC). The transfer of tax responsibilities, and the associated block grant adjustment which amends funding to reflect comparable tax receipts, means that weak forecasts can have a substantial negative impact on the overall Scottish Budget.

During 2018 the SFC have had a relatively pessimistic outlook for income tax forecasts and associated Scottish public finances. Whilst economic growth in Scotland has improved recently, this follows a period where Scottish growth was behind overall UK growth and this gap is unlikely to reduce based on current forecasts. If the economy grows slower in per capita terms than the UK overall, the SFC's forecasts for tax revenues, which will be published along with the Scottish Budget in December, will be considerably worse.

As outlined above, following the transfer of income tax responsibilities, the block funding provided by the UK Government only represents a proportion of the total resources available to the Scottish Government. The total money available will not be known until the Scottish Budget is published on 12 December, with details on council allocations to be announced in the local government finance settlement scheduled for 17 December. Due to tax revenue forecasts potentially having a significant negative impact on potential spending power, the size of the Scottish Budget is unlikely to be much different in 2019/20 compared to 2018/19.

With regard to the financial outlook beyond 2019/20, the Barnett Consequentials should mean that the position will improve from that forecast in December 2017. Despite the risks, the FAI anticipate that the Scottish Budget, on a like for like basis, is likely to increase by 3% between 2018/19 and the end of the parliament, although it will remain below the 2010/11 peak.

The FAI project that NHS spending in Scotland is likely to account for 50% of the resource budget by the start of the next decade. This, coupled with the increasing demand for health services arising from an ageing population and the Scottish Government's other spending commitments, means that the overall Scottish Budget is increasingly under pressure. This trend is likely to continue, with any further increases in health spending to meet projected growth in demand leading to further restrictions in funding for non-protected areas of the Scottish Budget.

In May 2018, following the publication of Scotland's Fiscal Outlook, it was estimated that spending on non-priority areas would decline by 12% over the remaining life of the parliament. Given that the previous Scottish Government commitment regarding health will largely be funded through the allocation of health related Barnett Consequentials, the outlook for non-priority areas has improved with spending forecast to decline by 4% over the remainder of the parliament. It is anticipated, therefore, that whilst the outlook for unprotected areas has improved from 2017 they are still likely to continue to face a challenging financial position, with reductions in funding for non-priority areas.

D.4 HORIZON SCAN – WEST LOTHIAN

EU Implications

In the 2011 Census, the total number of West Lothian residents from other EU countries was 5,112 with 85% of the total EU group of working age. Total West Lothian employment sustained by exports to the EU is between 4,500 and 5,000 jobs. Excluding retail, around 40 companies of scale are European owned with total employment approaching 2,000.

West Lothian Economic Update

Unemployment

Unemployment at local authority level is measured by the proportion of working age people not in work. In West Lothian this is 2.1% for September 2018 which is lower than the Scottish rate (2.7%) and British rate (2.2%) although it is an increase from June 2018. Youth unemployment figures were 490 (3.4%) compared with 465 (3.2%) in June 2018.

House Prices and Completions

The number of homes sold in West Lothian in June 2018 was 316 compared to 352 in June 2017. The number of house completions is a useful indicator of the building sector's sensitivity to changing economic conditions. The number of house completions in October 2018 was 81. This is an increase in the figure from September 2017 which was 41. The 2018/19 quarter 2 completions were 257 with 573 completions to date in 2018/19.

D.5 HORIZON SCAN – WEST LOTHIAN COUNCIL

Economic implications of the decision to leave the EU remain highly uncertain and may not be clear for some time. Brexit affects the future funding of public services through the impact it has on the overall economy as public finances, such as tax receipts, are highly sensitive to economic performance. It is almost certain that an economic downturn would lead to further public sector expenditure reductions.

In addition, whilst the council only has funding confirmed for 2018/19 and a one year settlement expected for 2019/20, it is clear from forecasts and commentators that public sector funding will remain constrained. The confirmation of the six priorities in the Scottish Government medium term financial strategy, and the commitment to direct health Barnett

Consequentials to health, would suggest that local government will continue to receive constrained core funding settlements. This position would only be further deteriorated if additional resources have to be allocated to health to address projected increases in demand not be addressed by current saving initiatives.

As the council has an approved five year strategy, it is in as strong as possible a position to address continued future restrictions in public sector funding. Economic and budget announcements will continue to be reviewed and taken into consideration to ensure that the approved financial strategy remains reflective of current assumptions. In particular officers will continue to monitor key announcements in relation to public spending, interest rates, CPI forecasts and economic risks, in order to assess the likely impact on the council's budget position for 2018/19 to 2022/23.

D.6 BUDGET PLANNING SCENARIO AND CHANGES TO THE BUDGET MODEL

The revenue budget for 2018/19 to 2022/23 was approved by Council on 13 February 2018. Officers continue to monitor announcements and other information to review and refine budget assumptions.

Work is currently underway to review and update the budget model in advance of the 2019/20 annual revenue budget setting process. This exercise is focused on re-evaluating the assumptions underlying the approved model, especially where additional information or updated forecasts could impact on the original financial values. In particular, the review will focus on high risk areas, such as pay award, grant funding and recurring budget pressures. In summary the main high risk areas currently being reviewed are:

Pay Award

The approved 2018/19 budget included pay assumptions based on the original offer to employees. Following discussions with the Scottish Government regarding teachers' pay award, COSLA increased this offer to 3% for all non-teaching staff earning up to £79,999. Although discussions are ongoing, with no agreement on the pay award for 2018/19, this increase in the offer will result in a budgetary pressure for the council. Any increase above the 3% offered would increase this budgetary pressure further. Given the ongoing trends in relation to pay negotiations, future year assumptions on pay are being reviewed.

Teachers Pensions

The Autumn Budget confirmed a reduction in the discount rate for calculating employer contributions in unfunded public sector pension schemes resulting in additional pension costs to employers. This change will impact on the cost of the teachers' pension scheme resulting in a substantial additional cost to the council. At this stage the Scottish Government has not confirmed that they will provide additional funding to offset this cost, although COSLA are strongly maintaining the case that the cost of this increase should be funded in full by the Scottish Government.

School Demographics

Following the implementation of a new pupil forecasting system, and recognition that recent house building has not met forecast completions, school demographic assumptions are being reviewed. The figures within the budget model were based on 900 forecast completions per annum. Although initial work has been undertaken, further work is required to finalise the forecasts.

Revenue Consequences of Capital Programme

The five year financial plan included provision for property revenue consequences arising from the draft ten year capital investment strategy which was approved at the same Council meeting in February 2018. Following approval of these strategies, there have been ongoing discussions and developments, especially in relation to new schools in the Winchburgh area and additional support needs investment. Work is ongoing to quantify the potential resources required to cover relevant revenue consequences.

Recurring Service Budget Pressures
As previously reported, officers have identified a number of recurring service budget pressures. Heads of Service are taking steps to address these pressures, as agreed by Council Executive in September and November 2018, and the position will be further reviewed in December.

Inflation and Indexation
Although the potential for inflation to be greater than forecast remains a risk, the forecast level of inflation is broadly in line with the assumptions included in the approved model. The only potential deviation is energy costs for 2019/20, where information provided by Scotland Excel and the Scottish Government shows that the unit cost of energy which has already been procured is higher than anticipated. Changes from the carbon commitment to the climate change levy may offset some of this additional energy cost.

Council Tax Income
As required by law the council tax income budget for 2019/20 will be updated to reflect the August Band D council tax return to the Scottish Government. In addition, the budget assumptions for future years will be updated to incorporate the reduced house building assumptions of 700 houses per annum.

Local Government Finance Settlement
With the publication of the local government finance settlement on 17 December 2018, the council will receive confirmation of grant funding for 2019/20. At this stage the council's assumption of a core grant reduction of £7 million is retained, phased as a £4 million reduction in 2019/20 and a £1 million reduction in each of the three years 2020/21 to 2022/23.

It is increasingly likely that the risks outlined above will result in an increased budget gap for the period to 2022/23. In February 2018, the forecast budget gap was £5.227 million. Following completion of the work to update the budget model it is anticipated that the updated gap may be more.

D.7 HORIZON SCAN BUDGET MODEL RISKS AND UNCERTAINTIES

In addition to the risks outlined in section D.6 of this report there remain a number of other risks and uncertainties in the long term financial assumptions underlying the budget model. These include the risk that the increase in costs associated with demand led services, such as social care, is greater than assumed and the emergence of policy or legislative changes by the UK or Scottish governments which restrict the council's flexibility to decide how to deliver services locally.

The nature of forecasting means it is challenging to identify with any certainty expenditure pressures and income. In addition, there are more general risks and uncertainties which will continue to be monitored. Some of the more general risks and uncertainties are:

- Economic growth being less than forecast, resulting in further public spending reductions.
- Funding not being provided to fully cover the costs of introducing new legislation.
- Policy changes by the UK or Scottish governments which restrict the council's flexibility to decide how to deliver services locally.
- Ring fencing of grant funding, constraining how local authorities allocate resources.
- Changes to local government remits with uncertainty for service provision and funding.

E. CONCLUSION

The report provides a high level overview of the latest economic indicators and other announcements likely to have a financial impact on the council. Following the outcome of the EU referendum, the negotiations required for the UK to leave the EU and to negotiate Britain's new trade relationships with the EU continue. Based on currently available forecasts and commentary, the outlook would suggest that in the short, medium and long term public finances will continue to be constrained. This will likely mean the funding envifronment for local government in Scotland generally and West Lothian Council specifically will remain challenging. The UK, Scottish, West Lothian and council position will be reported on a quarterly basis as part of the horizon scanning of factors that could have an impact on the council's medium term financial strategy. The council's funding for 2019/20 will be announced in the local government finance settlement on 17 December 2018. A report on the settlement will be presented to Council Executive in January 2019.

F. BACKGROUND REFERENCES

Fraser of Allander Institute Scotland's Budget Report 2018
(https://www.sbs.strath.ac.uk/economics/fraser/20181108/Scotlands-Budget-2018.pdf)

Appendices/Attachments: None

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