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 Panel:

1. Notes the results of the horizon scan for the UK, Scotland and West Lothian;
2. Notes the horizon scan for West Lothian Council;
3. Notes that officers are currently updating the council's budget model for 2019/20 to 2022/23;
4. Notes that the constraints in funding and expenditure pressures will lead to an increased budget gap for 2019/20 to 2022/23;
5. Notes the risks and uncertainties in relation to the council's budget model.

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 2018/19 to 2022/23. 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

It was previously agreed that the Head of Finance and Property Services would provide horizon scan and budget model updates to the Partnership and Resources PDSP on a quarterly basis to provide 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.

This report provides an update on key developments and potential implications following the UK referendum vote to leave the EU on 23 June 2016. 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 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 would also continue to be in effect until at least 2021.

On 15 January 2019, the Prime Minister's Brexit deal was defeated by 230 votes, with MPs voting by 432 votes to 202 to reject the deal which set out the proposed terms of Britain's exit from the EU on 29 March. Following this a confidence vote took place on 16 January 2019 and the Prime Minister won this vote by 325 votes to 306.

MPs are due to vote on a modified version of the Prime Ministers deal on 29 January 2019. The Prime Minister vowed to seek changes from the EU to the Irish "backstop" - the measures intended to ensure that whatever else happens, there will be no return to a visible border between Northern Ireland and the Irish Republic after the UK leaves the EU. The Prime Minister also scrapped the £65 fee EU citizens were due to pay to secure the right to continue living in the UK after Brexit. Outlining the proposed way forward, the

Prime Minister refused to rule out a no-deal Brexit and insisted there was no majority in the House of Commons for another referendum. Given the fast moving events in this area, a further verbal update will be provided at the Panel on any additional information that is available.

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

Economic Growth

The most recent update from the International Monetary Fund (IMF) in January 2019 was the World Economic Outlook Update. Growth estimates have been revised down for the UK with the IMF expecting growth to slow from 1.8% in 2017 to 1.4% in 2018. Growth projection for 2019 remains at 1.5%, however there is substantial uncertainty around this baseline projection, as this assumes a Brexit deal is reached in 2019 and that the UK transitions gradually to the new regime. However, as of mid-January, the shape that Brexit will ultimately take remains highly uncertain.

The most recent publication from the Bank of England in November 2018 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 21 December 2018 with growth improving in the third quarter by 0.6% between Quarter 2 and Quarter 3. Services remained the strongest contributor to growth in Quarter 3, construction and manufacturing also contributed positively to the growth. In comparison with the same quarter a year ago, the UK economy has grown by an unrevised 1.5%.

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 Britain buys from abroad more expensive, affecting the cost of living, but can also help to support UK exports. The pound has been making a very slow recovery against the dollar and, on 21 January 2019, the pound was $1.28 against the dollar and €1.13 against the euro.

The British Chamber of Commerce (BCC) published its Quarterly Economic Survey in January 2019. The latest survey finds that the UK economy ended 2018 stuck in a weak holding pattern, with stagnating levels of growth and business confidence as a result of heightened Brexit uncertainty and other economic pressures. The key findings were:

- Percentage of services firms reporting an increase in domestic sales and orders drops to two year low

- Recruitment difficulties in manufacturing joint highest on record, services sector recruitment difficulties hover near record-high

- Price pressures rise further for businesses, particularly manufacturers

Inflation

UK inflation, as measured by the Consumer Prices Index (CPI), was 2.0% in the year to December 2018, down from 2.2% in November 2018. The largest downward contribution came from falls in petrol and air fares, where ticket prices rose between November and December 2018, but by less than a year ago. These downward effects were offset by upward contributions from a variety of categories including accommodation services and, to a lesser extent, mobile phone charges, games, toys and hobbies, and food.

Interest Rates

The Bank of England Monetary Policy Committee (MPC) voted unanimously to maintain Bank Rate at 0.75% on 20 December 2018. At this meeting the MPC sets monetary policy to meet the 2% inflation target, and in a way that helps to sustain growth and employment. Since the MPC's previous meeting, the near-term outlook for global growth has softened and downside risks to growth have increased. The Committee judges that the loosening of fiscal policy in Budget 2018, announced after the November Inflation Report projections were finalised, will boost UK GDP by the end of the MPC's forecast period by around 0.3%, all else equal.

Unemployment

The latest figures published on 11 December 2018 was estimated at 4.1% over the period August to October 2018, virtually unchanged compared with May to July 2018 but lower than the estimate for a year earlier (4.3%). There were an estimated 32.48 million people in work, 79,000 more than for May to July 2018 and 396,000 more than for a year earlier.

In October 2018, the OBR updated their Economic and Fiscal Outlook. This shows the 2017 unemployment forecast as 4.4%, with forecasts of 4.0% in 2018, 3.7% in 2019, 3.8% in 2020 and 3.9% in 2021.

House Prices

The latest ONS House Price Index published on 16 January 2019 showed that in the year to November 2018 average house prices in the UK increased by 2.8%, up slightly from 2.7% in October 2018. 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.

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 means 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 0.3% in quarter 3, half the rate of the UK over the same period. This growth in quarter 3 represented a slowing of growth in Scotland relative to the previous quarter which was 0.5%. Latest forecasts suggest that growth in 2018 Q4 was 0.36% which, at an annual rate, is 1.46%. This is broadly in line with growth in the previous quarter.

The shape of economic growth in the UK and Scotland in the first three months of 2019 will be shaped by preparations for Brexit, and the extent of the resolution of the current uncertainty around Brexit.

Unemployment

The latest Labour Market Briefing, published in January 2019, showed that in quarter 3 2018, the unemployment rate was 3.6%, with 99,000 people unemployed. The rate of employment is 75.3% with earnings forecast to continue to be behind overall UK levels.

House Prices

The ONS publication for House Price Index (HPI) showed that the average house price in Scotland increased by 2.9% over the year to stand at £151,000.

2019/20 Scottish Budget and Longer Term Financial Outlook

The Cabinet Secretary for Finance, Economy and Fair Work, in a statement to the Scottish Parliament on 12 December 2018, announced the Scottish Draft Budget 2019/20. The Scottish Government published Local Government Finance Circular 8/2018 on 17 December 2018.

In overall terms, Scotland's total proposed spending plans, as set out in the Draft Budget 2019/20, amount to £42,539 million, an increase of £1,984 million compared to the Scottish Budget 2018/19. The total proposed spending plans include both revenue resource and capital spending plans with health and sport receiving the biggest increase in funding of £724 million.

Following the Chancellor of the Exchequer's Autumn Budget in October 2018, the Scottish Government committed to allocating the full health Barnett Consequentials of £550 million to health spending in Scotland. Health and sport received substantially more funding, with health resource spending increasing by 3.4% in real terms. Excluding capital, health now represents approximately 50% of the total Scottish resource budget. With health receiving additional resource funding over and above Barnett Consequentials, other portfolios have seen real terms reductions in revenue resource funding, masked to some degree in the totals by capital funding. Local government represents the second largest element of the overall Scottish Budget, and in the draft budget core local government funding has seen the majority of the reduction in resource funding.

The overall funding available to local government in 2019/20 will increase in cash terms, however the core local government settlement will decrease in real terms by 3.4% in 2019/20. This decrease is calculated after allowing for new specific grants, which are earmarked for delivery of Scottish Government priorities such as early learning and childcare, and the return of £150 million in general capital grant which was reprofiled from the 2016/17 local government finance settlement.

Providing some context, local government has seen its percentage share of the overall Scottish Budget falling year on year. In 2007/08, local government received 28.62% of the total budget. In 2019/20, based on the draft budget, local government's share will be 26.03%. As confirmed by the Fraser of Allander Institute (FAI), the headline local government settlement is flat in real terms only because capital and specific grants are included. The significant cash reduction in funding for existing council services received through the general revenue grant will have major implications for local service delivery in all councils.

Budget reductions have been delivered over a number of areas of the Scottish Budget however local government has seen largest reduction in core funding. Between 2016/17 and 2019/20, the core local government finance settlement will have decreased by 9% in real terms. The size of the local government budget means that substantial additional funding would be required to restore funding to 2016/17 levels in real terms. To restore core funding, £539 million would be required.

D.4 HORIZON SCAN – WEST LOTHIAN

<u>EU Implications</u>

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.

<u>West Lothian Economic Update</u>

<u>Unemployment</u>

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 November 2018 which is lower than the Scottish rate (2.7%) and British rate (2.2%).

<u>House Completions</u>

The number of house completions in December 2018 was 76. This is an increase in the figure from December 2017 which was 48. Completions to date in 2018/19 are 706, which is an increase of 244 from the same point in 2017/18.

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.

In addition, whilst the council only has funding confirmed for 2019/20, it is clear from forecasts and commentators that public sector funding will remain constrained. The confirmation of the six priorities, the Scottish Government commitment to health and the outcome of the 2019/20 local government finance settlement (LGFS), all suggest that local government will continue to receive constrained core funding settlements.

As the council has an approved five year strategy, it is in as strong as possible a position in the current climate 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. The approved financial plan included a budget gap of £65.3 million over the five years to 2022/23, with approved savings of £60 million. These savings are in addition to the £92 million of savings which the council delivered over the ten year period 2007/08 to 2017/18. Officers continue to monitor announcements and other information to review and refine budget assumptions. The main risk areas currently being reviewed are:

- Pay award
- Teachers pensions
- School demographics
- Revenue consequences of the capital investment programme
- Service budget pressures

- Inflation and indexation
- Council tax income
- Local Government Finance Settlement

The council received draft Scottish Government grant funding for 2019/20 in the local government finance circular published on 17 December 2018. As outlined in the Scottish Budget and LGFS report to Council Executive on 15 January 2019, the council's draft 2019/20 Scottish Government funding would be £322.862 million which is £4.692 million greater than the equivalent figure in 2018/19. Within the council's provision grant allocation for 2019/20 there is £9.462 million of funding which relates to new additional expenditure commitments. Taking account of this, the council's 2019/20 core funding from the Scottish Government for existing service delivery is equivalent to a £4.77 million reduction compared to 2018/19.

The approved 2019/20 revenue budget included a number of assumptions regarding grant funding. It was assumed that the council would receive a reduction in core funding of £4 million, offset by some additional funding for historic loans fund borrowing and the Living Wage for Social Care. The total budgeted grant movement for 2019/20 agreed on 13 February 2018 was a reduction of £3.27 million. The council's actual movement in Scottish Government grant funding for 2019/20 is a reduction of £4.77 million. This means that the 2019/20 settlement is £1.5 million worse than the budgeted position for 2019/20 assumed in February 2018.

The increased use of ringfenced funding for Scottish Government initiatives and priorities, means that total resources available to support existing core local service delivery are becoming very constrained. Since 2013/14, the council has received a cash increase in grant funding of £20.057 million but within that overall total cash funding of £35.446 million has been provided for a number of national commitments including, but not limited to, council tax freeze, health and social care and funding for schools. This means that over the period since 2013/14, the council has received a cut in core funding of £15.389 million.

Following the announcement of the draft local government finance settlement, officers have been reviewing the budget model to incorporate the updated funding for 2019/20. In addition, officers are reviewing expenditure assumptions to reflect any changes in circumstances since approval of the budget in February 2018.

Given the reduction in grant funding, and emerging increases in expenditure assumptions for items such as pay and superannuation, the budget gap to the period 2022/23 will increase. Taking account of the 2019/20 local government finance settlement, and the latest budget model assumptions, the Head of Finance and Property Services will present an updated 2019/20 budget, four year revenue financial plan and updated nine year capital investment programme to Council for approval in February 2019.

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, which has further moved to the downside as Brexit negotiations continue, 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 environment 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.

F. BACKGROUND REFERENCES

None.

Appendices/Attachments: None

Contact Person: Karen Park, Accountant (01506 283236)
Alice Mitchell, Economic Development Manager (01506 283079)

Donald Forrest
Head of Finance and Property Services

Craig McCorriston
Head of Planning, Economic Development and Regeneration

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