

DATA LABEL: PUBLIC



AUDIT COMMITTEE

SCOTLAND'S PUBLIC FINANCES: CHALLENGES AND RISKS

REPORT BY HEAD OF FINANCE AND PROPERTY SERVICES

A. PURPOSE OF REPORT

To provide the Audit Committee with a summary of the Auditor General's briefing paper *Scotland's public finances: challenges and risks* prepared by Audit Scotland in November 2022.

B. RECOMMENDATION

It is recommended that the Audit Committee notes the key messages and recommendations within the Audit Scotland report.

C. SUMMARY OF IMPLICATIONS

I	Council Values	Being honest, open and accountable, making the best use of resources and working in partnership.
II	Policy and Legal (including Strategic Environmental Assessment, Equality Issues, Health or Risk Assessment)	Relevant to council risk WLC026: "Failure to prepare and agree a medium term financial plan 2023/24 to 2027/28"
III	Implications for Scheme of Delegations to Officers	None.
IV	Impact on performance and performance Indicators	Ongoing restraint in relation to government funding inevitably has implications for the council's budget and performance.
V	Relevance to Single Outcome Agreement	Our public services are high quality, continually improving, efficient and responsive to local people's needs.
VI	Resources - (Financial, Staffing and Property)	Scottish Government grant funding is not sufficient to meet the increasing costs and demand for services.
VII	Consideration at PDSP	None.
VIII	Other consultations	None.

D. TERMS OF REPORT

D.1 Introduction

The pressures placed on Scottish public finances have been significant and varied for several years. The level of funding available to the Scottish Government has fluctuated and the Scottish public sector has had to adapt to these changes in funding levels as well as managing increasing demand for services and external events such as the Covid-19 pandemic and cost of living crises. The public sector also face higher operating costs, including higher labour costs as wages rise in response to inflation.

The briefing paper prepared by Audit Scotland focusses on the pressures facing the Scottish budget this financial year and in the medium term, and the implications this has for public services. It intends to inform and support scrutiny of proposed spending and tax plans in the current context, and emphasise the need for reform to public services. The briefing paper was written prior to the UK Government Autumn Statement on 17 November 2022 and the Scottish Budget 2023-24 presented to Scottish Parliament on 15 December 2022. In addition the Accounts Commission published the Local government in Scotland: Financial bulletin 2021/22 on 12 January 2023 and a report on this bulletin will go to Audit Committee in March.

D.2 Key Messages

The briefing paper includes a number of key messages and recommendations and is structured around three themes:

- Pressures on the Scottish budget
- 2022/23 and 2023/24 budgets
- Public services reform

In summary, the key messages are:

- Rising costs and increasing demands mean that the Scottish Government has to closely and carefully manage its position, to avoid the real risk that it will overspend on the 2022/23 budget.
- The Scottish Government has limited room for manoeuvre to make changes to balance the 2022/23 budget, and will face difficult choices setting the 2023/24 budget.
- The pace and scale of reform required across the public sector needs to increase.

The following sections provide more detail on the information contained in the Auditor General's briefing paper.

D.3 Part 1 – Pressures on the Scottish budget

Sustainability pressures on Scotland's public finances pre-date the current cost crisis and the Covid-19 pandemic, and have worsened because of them. In some cases Councils have used reserves to manage the funding gap but this is unsustainable.

No additional separate funding was provided by the UK Government for Covid-19 in 2022/23 although the long-term financial and operational effects of Covid-19 are still being felt. This means that the extra pressures caused by the pandemic are being funded through the core Scottish budget.

The current high levels of inflation bring further uncertainty and volatility to UK and Scottish government budgets. Inflation rates have hit 40-year highs in 2022/23. Increased inflation means that the public pound buys less than was expected when the budget was set. The UK Government has not changed its departmental spending this year to account for the higher costs facing the public sector and, because of inflation, the Scottish 2022/23 budget is worth less than when it was set.

The costs of supporting people through the crisis have increased through a combination of new support initiatives and higher than anticipated uplifts in current social security benefits because of higher inflation, and also increased demand.

Although the Bank of England do not expect inflation to remain high over the long term, the like-for-like increased costs e.g. pay awards, social security payments are locked in for future budgets and must be managed.

D.4 Part 2 – 2022/23 and 2023/24 budgets

The briefing paper highlights that without very close management of the budget, there is a real risk the Scottish Government overspends against its 2022/23 budget. The financial situation it faces is by far the most challenging since devolution. The Scottish Government has instigated substantial changes to spending during 2022/23 through the Emergency Budget Process to address the budget gap. Audit Scotland understands that HM Treasury rules mean that any overspend against the 2022/23 budget would be deducted from the following year's block grant, exacerbating pressures for the 2023/24 budget.

The briefing paper notes that Scottish Government and other public bodies will need to understand well in advance what constraints there are to their flexibilities to cut spending e.g. statutory services. In the short term much of the budget is fixed and committed and difficult to change quickly e.g. staff costs. In the medium to long term fewer costs are fixed and more can be changed.

It is acknowledged that the financial pressures faced may have implications for the scale, range and types of public services that can be provided. The current new financial realities mean that if the economic or fiscal environment continues to worsen, the Scottish Government may need to revisit all current priorities and policy commitments. Even if spending in priority areas is protected, services may be under significant pressure due to higher demands, especially on top of backlogs and challenges caused by Covid-19. An understanding of how decisions affect different groups is also required.

The Scottish Government will also have to consider UK Government policies when setting the 2023/24 budget. UK Government spending in devolved areas impacts the size of the Scottish budget and UK tax and social security policies also impact the size of the Scottish budget.

The briefing paper notes that the Scottish Government recognises the issues and risks relating to the sustainability of the public finances over the medium term, and is changing how it manages its financial sustainability risks. The core purpose of the Scottish Exchequer Directorate is 'a fiscally sustainable Scotland' and the Directorate has the goal of balancing the 2023/24 budget. The Auditor General notes that it is important that the results of the Scottish Government's fiscal sustainability work are transparently shown to improve scrutiny of the financial position, and to highlight risks early.

D.5 Part 3 – Public services reform

The Auditor General and the Accounts Commission have underlined the importance of reforming public services to manage the sustainability of public finances. The long term economic and fiscal outlook means that continuing to make small-scale budget cuts is unfeasible.

The Scottish Government Medium Term Financial Strategy (May 2022) and published alongside the Resource Spending Review (RSR) reflected a balanced medium-term position, where the central funding scenario and central spending scenario align. A key part of how the Scottish Government planned to close the funding gap was by making necessary budgetary savings through public service reform.

Reform should be planned and targeted and service delivery changed in a way that more effectively meets both the needs of users and the Government's policy aspirations. The Scottish Government's RSR includes reference to four main types of reform proposed by the government:

- New approaches to public services such as the establishment of the National Care Service and the National Strategy for Economic Transformation
- Public sector capacity and pay including a broad aim from 2023/24 to keep the total cost of the overall annual pay bill the same as 2022/23
- Efficiencies for the public sector including requiring recurring annual efficiencies of at least three per cent from public bodies
- Reform to public bodies noting that there are currently 129 public bodies in Scotland and 'reform is inevitable'

Both the Auditor General and the Accounts Commission have highlighted previously how difficult it is to reform public services. Audit work consistently shows a major implementation gap between policy ambitions and delivery on the ground. It is therefore important to take onboard the key learning points from past public service reforms to ensure expected outcomes are achieved. In the face of the financial challenges, the pace and scale of reform needs to increase, and this will require a sense of urgency from the Scottish Government, at a time when it is also pressing to resolve short-term issues facing the budget.

Other key points highlighted by the briefing paper in relation to reforming public services are:

- A shift to preventative spend is essential alongside meeting immediate challenges
- The Covid-19 pandemic has shown that public bodies can change how services are provided – and at speed
- The public should be fully involved in the key decisions about how public services will need to change
- It must be clear how changes in budgets affect performance if value for money is to be achieved
- Good quality data is required to link performance and budgets

D.6 Accounts Commission - Local government in Scotland: Financial bulletin 2021/22

The Accounts Commission published its annual review of local government finance on 12 January 2023, which was too late to prepare a report for this committee, with a report going to Audit Committee in March. However, the report does note that total revenue funding to councils from the Scottish Government decreased by 1.6 per cent in real terms in 2021/22 compared to the previous year and an increasing proportion of local government funding is now either formally ring fenced or provided with the expectation it will be spent on specific services.

E. CONCLUSION

The Auditor General's *Scotland's public finances: challenges and risks* briefing paper sets out the pressures facing the Scottish budget and the urgent case for the reform of public services. Audit Scotland will continue to monitor how the Scottish Government's financial position develops, through both financial audit work and performance audit work.

F. BACKGROUND REFERENCES

Scotland's public finances: challenges and risks

[Scotland's public finances: Challenges and risks \(audit-scotland.gov.uk\)](https://www.audit-scotland.gov.uk/scotland-s-public-finances-challenges-and-risks)

Appendices/Attachments: None

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