

ICAS response to the  
Scottish Parliament

12 August 2024



# Scottish Parliament inquiry Managing public finances in Scotland

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# Introduction

## About ICAS

The Institute of Chartered Accountants of Scotland (ICAS) is a global, professional membership organisation and business network for Chartered Accountants. It's also an educator, regulator, examiner and a professional awarding body.

ICAS' diverse membership is made up of over 24,000 world class business professionals who work in the UK and in more than 80 countries around the globe. Members of ICAS are also known by the letters CA, an exclusive professional designation in the UK.

ICAS members operate at the forefront of ethical and sustainable business. Educated, regulated, and led by the highest standards of ethical leadership since 1854, they are at the top of their game. They are trusted professionals, who transform business and support one another for the greater good.

Acting in the public interest is the guiding principle of all that ICAS does and we continually work to maintain trust in the finance profession. That ethos is enshrined in ICAS' internationally respected Code of Ethics – which applies to all members, students and member firms, and is underpinned by our Royal Charter commitment.

ICAS is a member of the Chartered Accountants Worldwide Network, a global family that brings together the members of 15 leading institutes to create a community of over 1.8 million Chartered Accountants and students in more than 190 countries.

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## Response to detailed questions

### **1. Are these the right priorities for the Scottish Budget 2025-26 and, if not, where should the Scottish Government focus its attention?**

The choice of priorities is a political decision. We have noted areas where we believe attention should be focused to support the achievement of priorities, based on our area of expertise and experience of our members (for further details see the following questions).

Achieving financial sustainability is critical to be in a strong position to meet future needs. Tax levers in Scotland are limited. Tax is not the only tool to increase revenues so to meet service demand, quality standards and the future challenges of an ageing population. All available levers to address financial sustainability should be considered. A critical appraisal of the potential revenue contributions from other areas and stronger controls on expenditure are needed to rebalance. Difficult decisions are to be made if this is to be achieved and communication, transparency and openness are important to manage this. (See also **question 7**).

Other drivers to improve financial sustainability include:

- Considering a range of approaches for broadening the tax base.
- Given financial challenges, the efficient and effective use of funding is of greater importance. If achieving financial sustainability and affordability is a priority, all significant decisions on spend and tax need the facts, figures, need and evidence to align with this priority.
- Other sources of revenue and maximising payback: the long-term perspective needs to include how to invest to generate future income to help reduce future problems and focus more strictly on needs and meeting them to maximise future returns. This includes business cases for significant expenditure (e.g. reform), capital expenditure, understanding the

consequences and costs of not meeting plans on time, understanding user needs, and making Scotland an attractive destination to encourage inward investment.

- Maximising the effectiveness of expenditure – we suggest the following:
  - Managing expenditure – a greater and consistent focus on VFM. This could also benefit by additional scrutiny and input from Audit Scotland
  - Building in early scrutiny and challenge of expenditure. This could include greater use of gateway-type evaluations and controls of expenditure profiles. Early review by Audit Scotland to check the foundations in place could support this. It may include adequacy of evidence, clear justified need and business case before committing to significant expenditure.
  - Improving productivity and efficiency is a critical partner to manage activity, not just increasing budgets and hoping it works out (see **question 4**).
  - An evidence and needs-based approach to decision-making, prioritisation and resource allocation (see **question 4**).
  - Progress monitoring and a consistent use of impact assessments to ensure policies and decisions are appropriate, achieving the planned impact and that funding is efficiently and effectively applied (see **question 4**).
  - The ability to progress, achieve outcomes and manage financial balance is a long-term endeavour (see **question 2**). We would welcome further clarity on how the tax policies align with the longer-term goals for economic growth and spending.

Other performance tools:

- Cross-cutting priorities need cross-lateral strategies which can demonstrate how they combine and contribute to the overall priorities – identifying, understanding and managing the trade-offs between combined areas is especially important to avoid gaps or duplication and to align all those involved to move forward in the same overall direction and to maximise impact.
- Clear and regular monitoring and progress reports to identify challenges, barriers, and corrections (before too much money has been spent). This could be supported by early-stage engagement of Audit Scotland to allow management arrangements and forecast costs to be independently reviewed at a time when changes can be made rather than after delivery and the money has been spent.
- Service user feedback and challenge is an important tool to identify problems and how to tackle them as part of improving services, monitoring quality and targeting user needs. We believe more consistent and routine efforts to seek users' views on services at the point of provision helps to identify problems, monitor quality and to inform improvements.
- Learning from and incorporating this wider perspective (including staff feedback) is an important tool to help focus attention on key barriers or challenges which may reduce productivity, hear suggestions for improvement, improve efficiency and evaluate VFM.
- In general, sound decision-making is supported by high quality information. Using relevant data to inform and report may be an area to develop.

## **2. What taxation and spending decisions should the Scottish Government take to make most progress against each of the First Minister's four priorities, within the current financial climate?**

Fundamentally, in our view, a much longer-term planning and budgeting to base tax, other funding and spending decisions on is required. This needs to be extended over a 10, 20 or 30+ years horizon (as appropriate) to show how Scotland's priorities can be achieved and funded. This supports efficient planning, effective use of resources, value for money and maximising investment /expenditure payback.

Longer horizons offer greater flexibility for managing challenges, meeting/ balancing future needs, managing capital expenditure requirements and understanding how well priorities are being delivered. A long-term approach is fundamental to the Scottish strategy, budget and tax policy. There are difficult

choices to be made which will need long-term horizons to plan and deliver whilst demonstrating efficiency and effectiveness.

Scotland has a small tax population and an even smaller group of higher earners. It is also subject to close competition from neighbouring jurisdictions with no barriers to entry. This combines to make Scottish tax decisions and quality of service provision highly sensitive to changes which may compare unfavourably with the rest of the UK.

The Scottish Government therefore needs to consider a range of methods and economic theories to widen the tax base so that more individuals and businesses pay tax which will increase revenues (see **question 7**).

The government also needs to make Scotland an attractive place to live, work and do business (from birth to death). Inward investment is important to create new technologies, products, services (including those we can export) and better paid jobs. Providing high quality education and careers/vocations is an essential element. This includes the transport infrastructure to support tourism, business across Scotland.

For education, Scotland also needs to demonstrate that it is achieving comparatively high performance to maximise the potential of children and adult citizens to have the skills, abilities and knowledge to support a growing economy. This focus on performance also serves to attract and retain talent from the rest of the UK and overseas.

Consistently benchmarking performance over time both locally, across the UK and internationally can inform the relative progress and success of policies, how well objectives are being met and impact/outcomes to inform future planning and actions. This needs to be easily accessible and widely cross-referenced so users and other stakeholders can get a clear and independent understanding.

Ensuring effective stewardship of resources and managing shortfalls needs sound investment decisions to strengthen the financial position of Scotland. It can be used to increase future revenues or enable modernisations and efficiencies to reduce future expenditure. This is a core need otherwise Scotland is not strongly positioned to achieve its intentions. Spending and longer-term investment should be clearly linked to the drivers of achieving financial health alongside strict stewardship of resources.

As an example, Scotland is currently facing higher demands in the NHS, yet patient outcomes are lower for accessing care (e.g. far longer waiting lists and access to cancer, primary and dental care). This has an impact on patients developing more acute conditions, potentially higher healthcare costs and reducing productivity of staff in jobs as they struggle with ill-health. Scotland is also experiencing an ageing population. The long-term effects of this trajectory need to be reviewed and addressed sooner than later to help restrain a trajectory of higher costs and demand. This may require modernisation and reform which will need significant funding. See **question 4**.

Key themes may help to focus decisions. For example, spending/ investment decisions may include:

- How does this support our priorities?
- How will this improve productivity, efficiency and value for money?
- Is this providing the most positive impact?
- Does this meet stewardship responsibilities?
- Does this meet the most important service needs and alleviate key challenges?
- Stimulating and embedding reform (both quick wins and more fundamental) which has evidence supporting improvements in efficiency, productivity, quality and performance.

Demonstrating how value for money is achieved during a period of restricted resources is crucial. This could present an opportunity for Audit Scotland to increase its work more on this aspect (as financial sustainability has become particularly acute) and on other key financial decisions (above). Given current circumstances it is prudent to challenge early and ensure evidence is robust to help rein in expenditure which may achieve a stronger impact elsewhere, or to illustrate where weaknesses/ gaps exist and address promptly.

Difficult decisions will have to be made and there will be consequences for many. Effectively communicating a balanced plan helps to get stakeholders on board with the reality and demonstrating effective challenge can support trust in government decisions. Robust and clear progress reporting by government needs to support this for monitoring impact, effectiveness, continuous improvement and to achieve both trust and support from citizens.

Supporting economic growth and financial well-being is critical to inform decision-making on tax and spend and to help improve living standards longer-term. Economic growth and pace of growth relative to the rest of the UK, is a key metric to reduce the need to increase taxes. The balance of tax-raising versus government expenditure affects the ability to increase the attractiveness of Scotland as a destination and for inward investment. It also has the potential to improve financial sustainability of public services. Where taxes are raised for revenue there also needs to be consideration of how investment and capital expenditure can enhance Scotland's economic growth and finances (as well as public services). We would like to see how the policy decision balances this.

For example, local taxes such as visitor taxes; deciding where to invest in to improve Scotland's competitive position versus the extra cost they may pay, involves understanding what tourists want and how best to invest to improve the economic return longer term. Moreover, this positive impact to encourage tourists needs knowledge of how well Scotland compares favourably or otherwise with competition across the UK and abroad to help target investment on areas of importance to visitors.

Spend decisions need to incorporate both short-term and long-term investment. The business case for investment is critical to provide a balanced view on how spending can improve productivity, standards of living and improve the quality of what Scotland has to offer to enhance its appeal as a business growth destination, tourism and inward investments which can help to make Scotland more competitive (both internationally and with the rest of the UK).

We would like to see what evidence of need has been used to inform investment decisions and allocation of resources. For example, for tourism what evidence is there of what tourists need, what attracts and deters them? Is there sufficient freedom to reallocate resources if there is evidence this could increase visitor numbers? What is the effect of the visitor levy on behaviours, is it meeting expectations and achieving the intended cost benefit?

### **3. What are the potential impacts of focussing budget decisions on these four priorities on those groups of society who traditionally experience inequality?**

See our responses to other questions.

### **4. What progress has the Scottish Government made against these specific goals in relation to public service reform?**

The strategic landscape still appears cluttered. The reporting of progress, outcomes, impact and achievement does not appear to be sufficiently clear or accessible for citizens. In particular, this includes understanding key themes such as performance, productivity, quality and impact at a national level (particularly over time). Simplification supports clearer communication to citizens.

Challenge and scrutiny should be encouraged. Impact assessments (in our view) should be undertaken more regularly and consistently to identify the effectiveness of policies, decisions and to support earlier learning on what needs to be changed and how, so we do not keep spending money on ineffective areas. Improving 360-degree evaluation of effectiveness in combination with impact assessments is a valuable tool to hold decision-makers to account and to be transparent with citizens about how well/ if policy decisions have achieved their planned objective.

Given the increasing importance of financial sustainability (which is becoming more acute) we believe that more emphasis could be given to value for money (for delivery bodies and government to demonstrate how well this value for money achieved) and on the scrutiny side (Audit Scotland) and wider challenge.

As an example, NHS Scotland has received approximately £6bn more in funding than 6 years ago but reports reductions in patient access to priority services (including waiting lists, cancer, primary and dental care). Although the NHS is facing increased demand, we need to understand to what extent the extra investment in the NHS is generating productivity gains and efficiencies over time or is there a downward trajectory of patient access outcomes. This is a critical area to investigate, to better understand where improvement may be needed to effectively allocate scarce resources, whilst still supporting other government services. (**See question 5**).

Improving productivity is a key gap in the strategy. More emphasis on understanding productivity and why it is decreasing or fluctuating or varying across Scotland, and what can be done to address this is critical.

We suggest that what constitutes reform could be clarified. It includes not just structural change where needed, it can also be a series of small steps and sharing this with bodies that can deliver a big impact with less upheaval. Using data to reduce variations has been found to be useful (e.g. in the NHS). Reform can be an accumulation of both minor and major reform to achieve quick wins and maintain momentum.

Reform may need investment to bring longer term benefits. There is a balance between using funds to invest now to generate future savings. This needs transparency over where future investment is needed and ensuring VFM. See **question 2**.

## **5. Are there any improvements that can be made to achieve faster progress with public service reform and improved outcomes?**

At this point, given the long-standing recognition that reform is required and that challenges still exist, we would stress the importance of getting the right foundations in place so actions can be more aligned, holistic, have the appropriate timescales and all relevant stakeholders are informed and on board.

We refer to the above comments on:

- a) Improving productivity, efficiency and VFM, measuring it and communicating it clearly across organisations, stakeholders and citizens.
- b) Embedding minor reforms (but not avoiding major reform if evidence and impact assessment show it is the right thing to do) through:
  - a. setting and embedding a culture of continuous improvement and learning from mistakes at all levels
  - b. promoting consistent application of good practice and
  - c. reducing variations in performance
- c) More consistent and widespread use of customer feedback on all services as a fundamental measure of performance and to help identify important barriers or opportunities.
- d) Ensuring alignment of policies and decisions with overarching priorities (see example in 6 below).
- e) High quality information and reporting on progress.

## **6. The Scottish Government recently published its Public Sector Pay Policy 2024-25 which offers pay metrics above forecast levels of inflation.**

*What are the implications of its multiyear framework on Public Sector bodies and on the Scottish Budget for 2025-2026? And for the subsequent two years?*

We note the revised pay policy, pay comparisons with the rest of the UK and private sector showing that the average public sector pay is higher in Scotland than the UK and private sector. The Scottish financial situation is particularly challenging. Whilst we understand that the ability to attract and retain quality staff is important and that a multi-year framework offers greater certainty, there are other

aspects to consider which seriously question the affordability of current arrangements and cast doubt on how this aligns with a need to balance the finances.

If it is a priority to achieve financial sustainability and reduce the risk to public services, it is unclear how this will be funded as tax-raising powers are limited and Scotland has a small population of taxpayers, especially higher taxpayers in Scotland. There is an important balance between spend and tax. This needs clarity on the evidence of need and trade-offs at a local and macro level to inform decision-making and show alignment with priorities.

Like all expenditure, affordability is a major consideration. Pay is a significant component of the Scottish public budget, accounting for over *half of the entire Scottish resource budget*<sup>1</sup> and around 2/3 of the NHS budget. It has reached a record high. The Scottish public sector is also comparatively larger than the rest of the UK and better paid with a widening gap<sup>2</sup>.

The policy states that *“key public sector roles in Scotland are now paid more than in the rest of the UK”*. It is debatable whether above inflation increases are consistent with the policy aim<sup>3</sup> to balance *“flexibility with fairness and affordability”*.

Audit Scotland also states in their workforce report<sup>4</sup> that *“The Scottish Government’s projections suggest that “it cannot afford to pay for public services in their current form. Reform is urgently needed to address budget shortfalls of more than £1 billion over the coming years.*

*“Recent pay deals exceed the Scottish Government’s public sector pay policy. £1.7 billion more than initially planned was agreed in pay deals for 2022/23 and 2023/24. These rises are locked into future budgets and are making it harder for the Scottish Government to manage pay costs over time.*

This suggests significant trade-offs need to be made, some of which can impact services over many years. It is another area of difficult choices. It is especially important to identify the longer-term macro consequences and ensure these are communicated to the stakeholders/ individuals involved and wider society so there is a clearer appreciation of the bigger picture, the impact on services and communities of maintaining an increasing pay differential. Above inflation pay rises for approximately 22.2% of employment in Scotland will likely have an impact on macro-economic factors related to inflation and wider society; it could even contribute to inflation. The impact of these macro factors are not always immediately visible.

We suggest that criteria could include:

- a) Whether pay decisions are affordable, how it will be funded and what the trade-offs / consequences are for all services over the short and longer-term.
- b) As a significant national employer, how pay awards align with Bank of England commentary and economic considerations about keeping inflation under control.
- c) Cross-laterally, what are the other factors, which could positively support the workforce and reduce current challenges.
- d) Are existing workforce policy positions supportive of moving towards financial sustainability or working against it.
- e) Performance is a tool to align pay with certain objectives and can be used to demonstrate contributions to VFM and productivity in certain areas or for key individuals. Performance related pay is commonly used in private and other organisations, so it is an area worth investigating further.
- f) Whether benchmarking information against the private sector and rest of the UK indicates a variance and how this is brought into decision-making and communicated widely to set expectations of what is/ is not feasible without having negative consequences elsewhere.

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<sup>1</sup> Quotes & facts (unless otherwise stated) from: [Public sector pay policy 2024 to 2025 - gov.scot](https://www.gov.scot/publications/public-sector-pay-policy-2024-to-2025/pages/1-2/) ([www.gov.scot](https://www.gov.scot)), page 1, 2

<sup>2</sup> The public sector accounts for 22.2% of employment in Scotland, compared to 17.8% across the UK (page 4)

<sup>4</sup> [The Scottish Government’s workforce challenges \(audit.scot\)](https://www.audit.scot/publications/workforce-challenges/)

- g) How the lowest paid and most severely impacted by inflation and costs are prioritised, especially when resources are scarce. This could involve deciding upon options which focus more on the lower paid end rather than a blanket award.

## **7. What elements should a new draft tax strategy include to achieve such a tax system?**

The Tax Advisory Group purpose includes providing advice on: *“the development of a tax system that is fit for purpose, delivers sustainable public finances and supports high quality public services and a flourishing economy”*. We agree with the purpose of the Tax Advisory Group but stress that tax is not the only tool and we would like to see similar focus on delivering sustainable public finances more broadly, without which it is severely restrained in the ability to deliver public services, achieve the level of quality needed and build a flourishing economy. See **question 1**.

If the priority is to ensure sustainable finances going forward, it needs to be supported by a wide-ranging toolset, incorporated across the Scottish government and its delivery partners and aligned in supporting strategies so everyone is pushing in the same direction. We suggest that the aim is to make the most of all available levers to keep finances balanced with needs and priorities. This includes tax, expenditure, other revenue, scrutiny and modernisation/ reform. See also **question 1**.

Scotland has small available population of taxpayers and even smaller group of high taxpayers. It is particularly vulnerable to behavioural change where tax levels are higher than the rest of the UK, or if incomes and standards of living are lower.

We encourage a wider review of theories and methods to widen the tax base. Tax is not just something to be avoided. Psychologically, it can let people know they are contributing to society. However, they also need to see what impact it has on public services and have a means to report where quality is below standard (performance feedback). Taking people out of tax can therefore be counter-productive if less engaged. Some believe that to widen the tax base and have lower overall rates of tax can raise revenue receipts.

Although an area of judgement, it is an alternative to the long-term predictions illustrated by the Laffer curve which shows how increasing tax rates exponentially leads to lower tax revenues and ultimately places a restraint on economic growth.

Progressive rates of tax are a good and worthy idea in principle. However, at a certain point people will compare their tax cost to others in other jurisdictions. Some will think they are glad to pay extra, but many will not. People also need to see that the tax they are paying is fully accounted for and can be seen to benefit society in everyday life. There is a case of visibility but also reassurance, trust and accountability to provide clear and transparent information on where the funding is being spent, why, if value for money has been achieved and the impact of spending. Clear, independent, factual and publicly accessible reporting of progress and outcomes in public services is important.

## **8. How should a new draft tax strategy address potential impacts of behavioural change on individuals, businesses, and the overall tax take?**

To see behavioural change the data must be available in granular detail. Otherwise, avoidance behaviours such as not taking promotions, putting more into pensions, retiring early, not moving to a bigger home and moving to another jurisdiction can get lost. These wider unintended consequences are sometimes not visible or quantifiable.

The Scottish Fiscal Commission (SFC) included estimates of behavioural change in its forecasting in 2023 for the first time. Further investigation is needed to understand and estimate behavioural changes more accurately.



## **9. What actions should the Scottish Government take to grow the tax base and increase labour market participation, productivity, and Scotland's economic growth?**

Scotland needs to consider its competitiveness in terms of taxation, its population and look at the potential population decline over the next 50 years and cast a forward glance to emergent technologies, business initiatives and growth measures which will combine to grow the economy. It is about population, education, infrastructure and opportunity.

## **10. What steps should the Scottish Government take, in its Budget for 2025-26, to grow the economy in this way?**

### *Double materiality and decarbonisation*

At ICAS we strongly support channelling time and funds towards decarbonisation activities that effect a just transition. And comprehensive and balanced sustainability reporting should provide the information and data to facilitate this, by disclosing the impact of an organisation on people and planet as well as the impact on an organisation of people and planet.

Analysing the disclosures of the impact of an organisation on planet and people, including progress against transition plans, will reveal opportunities for climate mitigation measures.

Reviewing the disclosures of the impact on an organisation by planet and people, will show risks and opportunities presented by the climate to energy and infrastructure in different parts of the country.

In addressing climate mitigation and adaptation measures in a systematic and focused way, the Scottish government can identify areas of economic growth that serve Scotland achieve its target date for net zero emission of all greenhouse gases by 2045. We welcome the reestablishment of new interim net zero targets, to drive badly needed action in the near term.

## **11. Given the limited capital budget available, in which areas should the Scottish Government prioritise its capital spend in the Scottish Budget 2025-26 to deliver increased productivity, innovation, and growth?**

*The SFC forecasted that Scotland's capital budget is expected to fall by 20 per cent in real terms between 2023-24 and 2028-29.*

Given the scale and imminence of the variance, it is not clear how stewardship and VFM can be achieved on capital expenditure if decisions are taken on a short-term basis.

This not a sustainable position and risks creating more costs. Capital costs should be planned and accounted for on a long-term basis. A longer-term strategy and resource plan are needed to support more efficient allocation of resources and addressing risks.

There also needs to be greater focus on identifying the added costs and trade-offs both short and long-term, across multiple stakeholder groups to scrutinise and challenge any policies and decisions which may not appear consistent with the vision for sustainable finances, operating within affordability constraints and fairness.



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