

MEETING: 20TH SEPTEMBER 2010

SUBJECT: BUDGET PLANNING FRAMEWORK 2011/2012

JOINT REPORT OF THE CHIEF FIRE OFFICER AND FINANCE OFFICER

1.0 Introduction

1.1 This report sets out the macro economic and legislative environment which forms the budget planning framework for the production of the Budget for 2011/12 for the Fire Authority and provides a basis for the development of the Medium Term Financial Strategy (MTFS), which will be presented later in the year.

2.0 National Financial Outlook

2.1 In considering the budget planning framework for 2011/2012 there is a need to consider:

- the national economic position and various key economic indicators;
- the impact of those key indicators on the Authority's financial position;
- how the Authority needs to respond both in the short and medium term in order to continue to meet the Authority's priorities taking into consideration the wide range of uncertainties.

Factors Contributing to the National Position

2.2 The following key economic indicators seek to illustrate the overall national economic position and outlook:

Government Borrowing

2.2.1 The financial crisis has led to a significant increase in borrowing as a result of the government injecting additional resources to support financial institutions and to seek to stimulate the economy. The latest government forecasts show:

- total borrowing is estimated to increase from £772.1 billion at the end of 2009/2010 to £1,284 billion in 2014/2015;
- in year borrowing is estimated to increase from £155.1 billion in 2009/2010 to £159.9 billion in 2010/2011;
- debt servicing costs are set to increase from £30.9 billion to £67.2 billion by 2014/2015.

In addition to the costs of debt servicing there will also be pressure on the government to repay debt in order to reduce the current level to a more sustainable level in the longer term.

Inflation

2.2.2 There have been increases in the measures of inflation over the last eighteen months; however the level still remains low. Latest forecasts suggest that the low level of inflation currently being experienced will remain for 2011/2012. These indicators are set out below:

Current Rates

- Consumer Price Index (CPI) – 3.1%
- Retail Price Index (RPI) – 4.8%

Average of Forecasts 2011/2012

- Consumer Price Index (CPI) – 2.0%
- Retail Price Index (RPI) – 3.55%

The position remains uncertain and forecasts continue to be regularly monitored and revised.

Interest Rates - Base Rate

2.2.3 The all time low Bank Base Rate has remained consistent since March 2009 at 0.5%, with views varying on when an increase in interest rates will occur. Clearly major factors will include the levels of growth and inflation within the overall economic position and how those are viewed by the Monetary Policy Committee.

Public Sector Spending Plans

2.2.4 In addressing the current budget deficit the Coalition Agreement issued on 20 May 2010, stated that “deficit reduction, and continuing to ensure economic recovery, is the most urgent issue facing Britain.”

The Emergency Budget issued in June was the first step in addressing this deficit. The Comprehensive Spending Review 2010, due to be announced on 20th October will provide the framework for delivering the deficit reduction with anticipated significant cuts across the whole of the public sector, including local government.

Impact on the Fire Authority’s Financial Position

2.3 The above factors are considered likely to impact on the Authority’s financial position in the following ways:

- significant real terms reductions in government grant settlements from 2011/2012 for an uncertain period, but likely to extend for at least four years;
- interest receipt levels from deposits are likely to be low for some time;
- spending pressures arising from inflation, fluctuations in interest rates, pay awards, and demand for services will all have to be accommodated from the reduced levels of grant support that will be announced in the Spending Review in October 2010.

3.0 Emergency Budget Announcement of 22nd June 2010

Spending Review

- 3.1 The outcome of the Coalition Government's Spending Review is to be announced on 20th October 2010 and will set out in detail Departmental Spending plans and the extent of cuts in grants to local government and other agencies.

The timing of the announcement is not helpful as the detailed information in the Spending Review is required to inform the Authority's financial planning processes.

It is worth noting that, in a speech to the Local Government Association on 27th July, the Secretary of State for Communities and Local Government, Eric Pickles, stated that ministers were contemplating giving councils consecutive two year settlements to cover the next spending review period. As well as pushing significant financial reform back until 2013/14, such a move would mean councils will know nothing about the level of grant they will receive in 2013/14 or 2014/15. Although a final decision has not yet been made on the settlement, it was stated that reform would be the focus of the second settlement. Obviously, this will reduce the level of certainty within the Medium Term Financial Strategy for those years.

Level of Reductions

- 3.2 In total £61 billion of Departmental budget reductions over the next 4 years (2011/012 to 2014/2015) have been announced. This is an extra £30 billion of budget reductions compared to previous government announcements as part of the March 2010 Budget. Health and Overseas Aid budgets are to be ring fenced and schools partly protected. This means that other Departmental Expenditure Limit figures will be cut by at least 25%, in real terms, over the next 4 years, with potential for 33% reductions because of the impact of protection.

Initial broad assessments based on a 25% - 33% cut in grants would mean a reduction of £9m to £12m over the next four years (£2m to £3m per annum) for the Authority. However, there is significant uncertainty with these initial assessments and the true position will not be known until the Spending Review is announced in the autumn.

Capital Spending

- 3.3 No further cuts in capital spending totals were indicated in the Emergency Budget beyond those announced at the end of May 2010 as part of the £6.2 billion in year reductions for 2010/2011.

The Coalition Government has indicated that it will monitor lending from the Public Works Loans Board more closely and will consider the approach taken in Scotland to increase transparency around borrowing undertaken more than two years in advance of expenditure.

It is hoped that the Coalition Government does not seek to limit any of the current freedoms for the Authority to make its own borrowing decisions.

Pay Freeze

- 3.4 A two year pay freeze for public sector workers (2011/2012 and 2012/2013) was announced, except for those workers earning less than £21,000 a year, who will receive an increase of £250 per year. Local government pay remains a matter for free collective bargaining between the national employers and trade unions through the National Joint Council. The Coalition Government has confirmed that its assumptions about pay awards in local government for the next two years will be fed into the forthcoming spending review.

Pensions

- 3.5 There will be an independent commission chaired by John Hutton to undertake a fundamental, structural review of public service pension provision in time for the Budget 2011. Consideration will be given to the case for short-term savings in the Spending Review period, by September 2010. Further details will be required to understand any budget implications for the Authority.

Council Tax Freeze

- 3.6 The Coalition Government has stated that they will work in partnership with local authorities to freeze Council Tax for 2011/2012 and will offer some limited grant incentive for low spending councils to achieve this impact on the budget.

If grant funding is provided, the difficulty will be the replacement of the one off resource once the grant funding ends, leading to a shortfall in funding for the longer term.

VAT Increase

- 3.7 VAT at the standard rate is to increase from 17.5% to 20% from 4th January 2011.

Consideration will need to be given to the Authority's fees and charges policies to reflect the new VAT rate.

4.0 Other Consultations

Veto on Council Tax Increases

- 4.1 The Government is consulting on proposals to introduce a new system in respect of council tax increases, the details of which are set out below.
- 4.1.1 The secretary of state will have power each year to determine a principle in respect of council tax increases based on a comparison

with the level in the previous year; these principles are to be published at around the same time as the Local Government Finance Settlement in December/January. The Secretary of State will also have power to determine different sets of principles for different categories of local authorities.

- 4.1.2 Any Authority which exceeds the principles will be required to produce two budgets, a proposed budget based on the proposed council tax increase and a shadow budget based on the principles set by the Secretary of State. A referendum of all registered local electors would then need to be held. The organisation and administration of referendums will fall to billing authorities and will be based on the existing provisions for mayoral referendums. There will be no minimum requirement for voter turnout and the conclusion will be based upon a simple majority vote.
- 4.1.3 If the proposed council tax rise were rejected, the Authority would need to adopt the shadow budget, amend its council tax, and issue new council tax bills.

5.0 Review of Local Government Finance Formula Grant Distribution

- 5.1 The Government have been reviewing the formula used to allocate formula grant, a consultation paper has been issued which proposes a number of changes to the system. It should be noted that the outcome of the consultation will not inform the resource allocation for local government, this will be determined by the comprehensive spending review, but it will determine how the total resource is allocated to individual authorities.
- 5.2 The options presented in the consultation paper are around the source data used in the formula and whether this should be updated or a different formula used. Details of this are given below together with an indication of the impact of each on the Authority:
 - 5.2.1 Fire and Rescue – Two options are proposed to update the expenditure base used for regressions in the current formula. Option 1 uses the latest available data from the Revenue Outturn returns produced annually by local authorities for central government. Option 2 uses the same expenditure base but adds in annual cash efficiency savings over 2006/2007 to 2008/2009. Both options have a detrimental effect on the Authority's grant allocation.
 - 5.2.2 Day Visitors – It is proposed that this indicator is replaced with 'foreign night visitors' as the data for day visitors no longer exists. This would have the effect of marginally decreasing the grant allocation to the Authority.

- 5.2.3 Area Cost Adjustment – It is proposed that some of the weights for the labour cost adjustment are reduced; this would have a marginally negative impact on the grant allocation to the Authority.
- 5.2.4 Central Allocation Scaling Factor – It is proposed that the weighting between the central block, the relative needs block and the relative resources block are adjusted. Increasing the weighting of the relative needs block would have the effect of decreasing the grant allocation to the Authority.
- 5.2.5 Floor Damping – The option is whether to set the floor close or further away from the average grant increase or decrease. If the floor is set close to the average grant the distribution will be similar to that for the adjusted prior years grant, however, if the floor is set further away from the average, more of the formula change will come through for those authorities above the floor, as is the case for this Authority.
- 5.2.6 Working Tax Credits – The proposal is to replace the indicator ‘children in income support families’ with ‘child tax credit’; this would be detrimental to the Authority’s grant allocation.
- 5.3 Presently there is a consensus of views across all metropolitan fire authorities that the proposals are detrimental to the grant allocations for metropolitan fire authorities and grant allocations should not be changed at a time when there is likely to be sweeping cuts in formula grant for at least the next 4 years.
- 5.4 A joint response to the consultation paper is being progressed by the Association of Metropolitan Fire and Rescue Authorities.

6.0 General Principles Influencing the Budget Planning Framework

- 6.1 All of these factors will present significant challenges to the Authority and, as soon as the financial settlement is known, an options paper will be prepared for Members setting out the implications for the Fire Service of the settlement as well as outlining proposals on how to address the shortfall in funding. In the interim however, the following general factors are pertinent:
 - 6.1.1 Firstly, the Authority has a statutory duty to undertake prevention, protection and response duties. Consequently, entirely ceasing work in these areas is not an option. However, the extent to which provision needs to be made to undertake such duties, and how they are prioritised in relation to one another, remains a decision for the Authority.
 - 6.1.2 Secondly, due to the successful implementation of efficiency measures over several years, the Authority has ensured that it has a degree of flexibility both in terms of the prioritisation of the spending reductions

and also with regard to the timescale over which such reductions will have to be made. It must be noted, however, that this flexibility does not extend to the point where the revenue budget can be permanently insulated from external financial pressures.

- 6.1.3 Thirdly, the Authority has a reputation for being an employer that values its employees. This is borne out via such external bodies as the IIP and, anecdotally, through informal conversations and contact with staff. This hard won reputation is one that should inform the future strategy as far as practicable.
- 6.1.4 Finally, the Authority has a history of managing reductions in staffing levels in a gradual manner for staff with permanent contracts. Whilst it must be borne in mind that the Authority has never been faced with the financial problems currently facing the public sector, it is anticipated that Members will wish to continue with this approach and aim to achieve any necessary reduction in the overall size of the service without recourse to compulsory redundancies.
- 6.2 Adopting such an approach will provide staff with some degree of reassurance in these uncertain times, although it must be acknowledged that whether such a strategy can be delivered will not be known with certainty until the exact size of the budget cuts are revealed.
- 6.3 However, combining the general principles set out above with the Authority's existing review mechanisms, such as Integrated Risk Management Planning (IRMP), will ensure that the Authority has the ability to identify all of the options available to it with regard to addressing the anticipated budget shortfalls, as illustrated in paragraph 3.2 of this report.

7.0 Conclusion

- 7.1 This report sets out the macro economic and legislative environment which forms the budget planning framework for the production of the Budget for 2011/12 for the Fire Authority and provides the basis for the development of the Medium Term Financial Strategy (MTFS).
- 7.2 As outlined above, the budget planning framework and MTFS for 2011/2012 will be produced taking into consideration spending pressures arising from inflation, fluctuations in interest rates, pay awards, and demand for services all of which will be accommodated from the reduced levels of grant support anticipated to come out of the Spending Review in October 2010 and any possible grant reductions which could arise out of the review of Grant Formula.

8.0 Recommendations

- 8.1 The Authority is requested to note this report as the basis on which the Budget for 2011/12 will start to be produced and also note that a fully updated Medium Term Financial Strategy will be presented to the Authority meeting on 22nd November 2010, taking into account the outcome of the Spending Review announcement on 20th October 2010.