Press Release
18th June 2009

ANALYSIS OF GOVERNMENT EXPENDITURE AND REVENUES IN SCOTLAND (GERS) 2007-08 PUBLICATION

MAIN FINDINGS

- In 2007-08, the estimated fiscal balance in Scotland, excluding North Sea revenue was a deficit of £11.1bn
- If a geographic share of North Sea revenues are included, this deficit is reduced to £3.8bn
- There are no significant changes to the methodology since last years report
- The main variable in the calculation is North Sea revenues, which, in total, fell from £9.1bn in 2006-07, to £7.8bn in 2007-08. This variation is expected to continue with H.M. Treasury projecting North Sea revenues rising steeply in 2008-09 to £12.9bn then falling back again in 2009-10 to £6.9bn. (All figures are UK totals.) Scotland's share of North Sea revenues (based on geographical share) was £7.7bn in 2006-07 and £7.3bn in 2007-08 (note Scotland's share of North Sea revenues rises from 84.5% to 93.5% in this period). The forecasted Scotland share for 2008-09 and 2009-10 is £12.1bn and £6.4bn, respectively, assuming Scotland retains 93.5% of revenues.
- Excluding North Sea revenues, Scotland's deficit as a share of GDP is around 10%, which is above the UK share of around 2.5%
- Adjusting the Scottish deficit for the UK deficit (both excluding North Sea revenues), using population share (8.5%), means that, if the UK government budget were in balance Scotland would have an underlying deficit of around £7-7.5bn
- This is roughly the size of the gap that would need to be filled by North Sea revenues for the Scottish Budget to be in balance.
- Figures for past and projected years show that Scotland has been both above and below this level for North Sea revenues

(Note: any North Sea revenues that are used to balance the Scottish budget would be unavailable to be added to any Norwegian style Futures/Oil Fund.)

Chart 1 highlights the estimates made of the historical net fiscal transfer between Scotland and the rest of the UK. Care should be taken in interpreting the data as not all figures have been produced based on the same methodology. However, the general picture of a transfer out in the 1980's, when oil prices were high, followed by a net transfer in, during the lower oil price 1990's seems reasonably robust. Figures shown post GERS 2007-08 are illustrative, based on the assumption that the non-oil deficit remains the same but that the oil revenues move in line with Treasury projections from the 2009 Budget.

Chart 1: Scottish Fiscal transfer, 1980-01 to 2006-07 (2007-08 to 2009-10 is a forecast[a]) – 2003 prices

[a] Takes nominal 2007-08 transfer (excluding North Sea revenue) as fixed and then subtracts forecasted North Sea revenue (based on Scotland's share being 93.5% which is 9% higher in 2007-08 compared to 2006-07 – see GERS Table 5.4)

Chart 2: North Sea oil & gas revenues & Brent oil price (2008-09 prices)

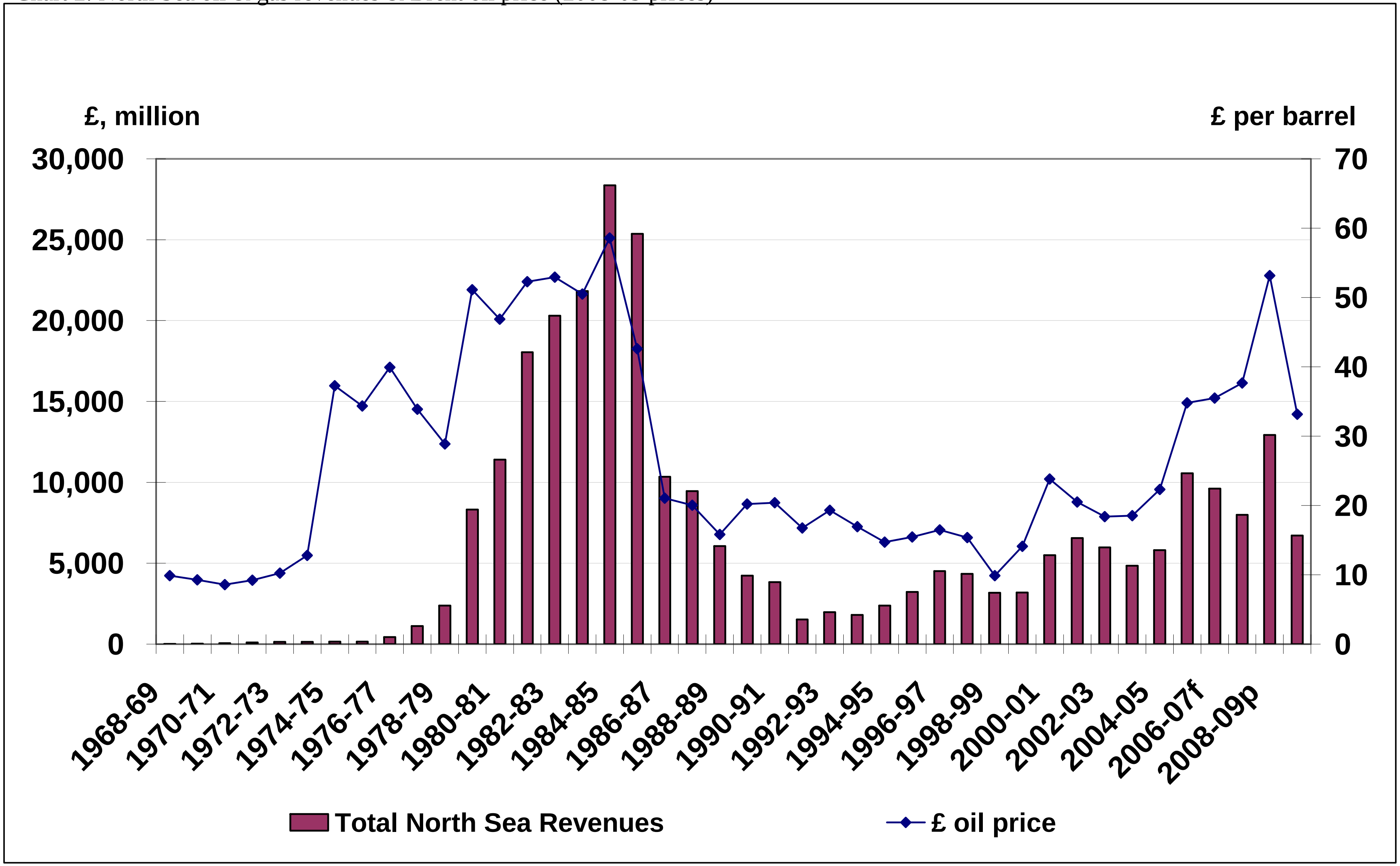

Chart 2 highlights, in real terms, the movement of oil prices and UK oil revenues over time, highlighting their erratic nature. Whilst oil revenues are forecast by H.M. Treasury to reach about £13bn in 2008-09, estimates for 2009-10 are for this to fall dramatically to around £7bn (-47%).

Background

The usefulness of GERS lies in suggesting where Scotland stands under the existing tax and spend policies. As such, any changes to current circumstances can be estimated in order to come to a new fiscal balance under these new circumstances.

GERS is less useful in predicting what the future fiscal balance including North Sea revenues might be due to uncertainty over future production levels and over future price levels. To give some idea of this uncertainty – oil production from the North Sea has fallen 40% in under 10 years on its 1999 peak, while in the same period the price has varied from around $10 a barrel to $150 a barrel. In addition, neither the market nor government have a very good record in forecasting total expected oil production or future prices. Such uncertainty means that there will always be a degree of risk attached to future revenue levels from oil, although these risks have both an upside and a downside.

The last two GERS reports (unlike their predecessors) make much of the distinction between what is termed the overall fiscal balance (the difference between total expenditure and total revenue in Scotland) and the current fiscal balance (which excludes most capital spending). We prefer to concentrate on the overall fiscal balance as we are considering GERS within the current fiscal framework for Scotland, and not one where there is greater/total fiscal autonomy. This current framework in which GERS operates therefore provides information on how much of the total expenditure undertaken in Scotland is met from an estimate of revenue attributed to the Scottish tax base (plus any operating surpluses from government owned assets and – when included – the tax revenues from North Sea oil that is extracted from Scottish territorial waters).

In addition: (i) the EU and most countries use either the public sector or the general government fiscal balance as the bottom line for the sustainability of imbalances. Hence, the Maastricht criteria of 3% of general government borrowing as a share of GDP limit; (ii) when planning future budgets the Norwegian government balances its overall budget before putting any remaining oil related revenues into it's Pensions Fund

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