CPPR pre Budget Briefing
19th September 2012

CPPR
Centre for Public Policy for Regions

The attached briefing note highlights the long term funding landscape against which the Scottish Government's budget takes place this week.

Highlights

- Over the period 2009-10 to 2016-17, the Scottish Governments overall DEL budget is projected to fall by £5.5 billion, or by 18%, in real (inflation adjusted) terms.

- By the end of the current financial year (2012-13), it is expected that almost half of this fall will have taken place. However, whilst in the case of the capital budget this figure is close to 75%, in the case of the resource budget it is close to 33%.

- Post 2014-15, the position is complicated by the extent to which additional UK level cuts (announced at the time of the last Autumn Statement) will be found from the welfare budget.

- Post 2014-15, there is uncertainty over the degree to which the budget for the NHS, especially its resource budget, will be protected. While this does not affect the overall Scottish Government's budget position, it has significant consequences on how the budget is allocated between NHS (around 30% of the Scottish budget) and non-NHS services.

- Post 2016-17, the Scottish Budget is currently projected to rise again in real terms. However, with poorer growth prospects than a year ago this may not be the case when the UK Government looks again at public finances at the time of the next Autumn Statement (5th December 2012). In particular, if the NHS continues to be protected, then other budgets face the prospect of continuing cuts or only low-to-no growth.

The above analysis highlights a fiscal landscape, stretching into the horizon, of continuing financial challenges.

Indeed it could be argued that such challenges will intensify as (i) the low hanging fruit, in terms of efficiency savings, will already have been picked and (ii) at present, 2015-16 and 2016-17 may prove to be two of the most difficult years to negotiate in terms of the Resource budget.

The main 'known' in this landscape is the on-going squeeze on public funds, especially when rising demands are also taken into account.

The main 'unknown' is the degree to which economic growth will return. The more growth there is then the more flexibility there will be with respect to future budgets, but at present the potential source(s) of such improved growth are unclear.

CPPR briefing note on the background to the 2012 Scottish Budget

This briefing highlights the long term funding landscape against which the Scottish Government's budget takes place this week. It covers:

1. An updated assessment of the Scottish Government's DEL actual and projected spending
2. The potential for extra welfare spending cuts
3. The impact of continuing protection of NHS spending
4. Prospects beyond 2016-17

1. Scottish Government DEL actual and projected spending

In Tables 1(a) and (b), below, we have attempted to estimate the change in the Scottish DEL Budget, in both cash and real terms, from its peak in 2009-10 to 2016-17. The figures are consistent with those published by the Scottish Government, as shown in Chart 1[1].

Table 1(a): Scottish DEL 2009-10 to 2016-17, £ billion (cash and 2010-11 prices)

	Out-turn			Current	Forecast		Projected	
	2009-10	**2010-11**	**2011-12**	**2012-13**	**2013-14**	**2014-15**	**2015-16**	**2016-17**
DEL Resource								
Cash	25.4	25.9	25.6	25.9	26.1	26.2	25.9	25.8
(£ change, yr-on-yr)		0.5	-0.4	0.3	0.2	0.2	-0.3	-0.1
(% change)		2.1%	-1.4%	1.2%	0.7%	0.6%	-1.1%	-0.4%
2010/11 prices	25.9	25.9	25.0	24.7	24.2	23.8	22.9	22.3
(£ change)		0.1	-0.9	-0.4	-0.4	-0.4	-0.8	-0.6
(% change)		0.3%	-3.5%	-1.4%	-1.8%	-1.8%	-3.5%	-2.8%
DEL Capital								
Cash	4.0	3.3	2.8	2.7	2.4	2.4	2.4	2.4
(£ change)		-0.7	-0.5	-0.1	-0.3	0.1	0.0	0.1
(% change)		-16.8%	-16.1%	-2.0%	-12.7%	3.1%	-1.9%	2.2%
2010/11 prices	4.0	3.3	2.7	2.6	2.2	2.2	2.1	2.1
(£ change)		-0.7	-0.6	-0.1	-0.4	0.0	-0.1	0.0
(% change)		-18.3%	-17.9%	-4.6%	-14.8%	0.6%	-4.3%	-0.3%
Total DEL								
Cash	29.4	29.2	28.3	28.6	28.4	28.7	28.3	28.3
(£ change)		-0.2	-0.9	0.3	-0.2	0.2	-0.3	0.0
(% change)		-0.5%	-3.0%	0.9%	-0.6%	0.8%	-1.2%	-0.1%
2010/11 prices	29.9	29.2	27.7	27.2	26.4	26.0	25.1	24.4
(£ change)		-0.7	-1.5	-0.5	-0.8	-0.4	-0.9	-0.6
(% change)		-2.3%	-5.1%	-1.7%	-3.0%	-1.6%	-3.6%	-2.6%

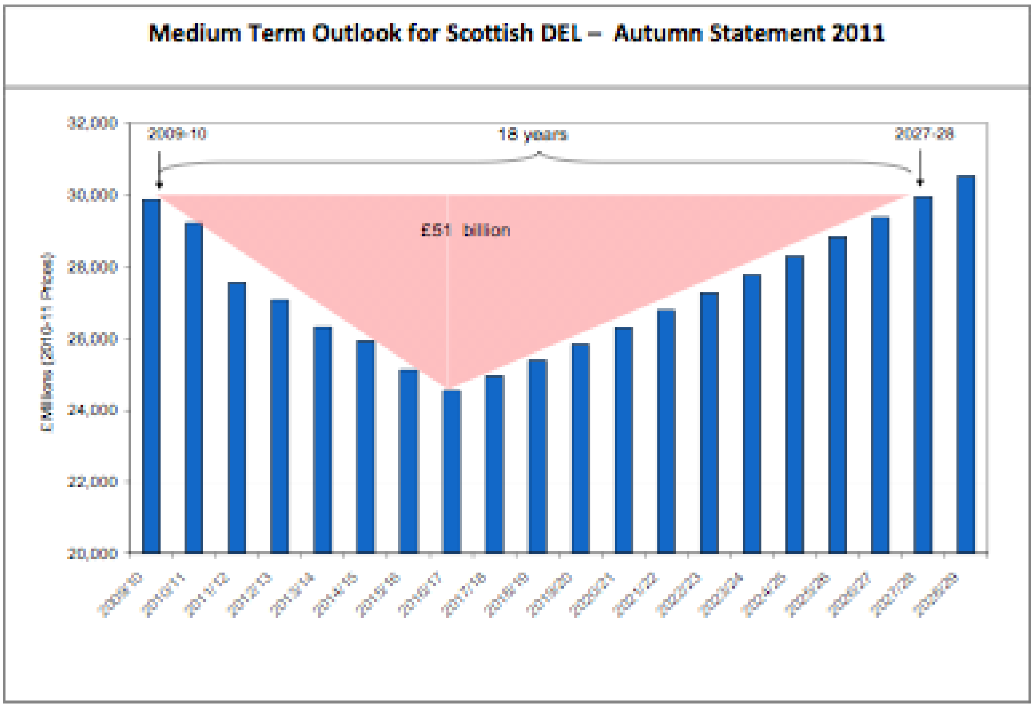
Sources: 2009-10, SPICe, Draft Budget 2010-11; 2010-11 to 2014-15, Scottish Government Draft Budget 2012-13; 2015-16 & 2016-17, calculated using DEL spending growth rates, Scotland adjusted, from Table 4.15 of OBR's March 2012 Economic and Spending Outlook.

[1] The 2015-16 to 2016-17 figures are CPPR projections based on UK Budget 2012 data, and are comparable to those calculated by the Scottish Government, which are based on UK Autumn Statement 2011 data.

Table 1(b): Changes in Scottish DEL

	DEL Resource		DEL Capital		Total DEL	
	Cash	2010-11 prices	Cash	2010-11 prices	Cash	2010-11 prices
2009-10 to 2016-17						
- £ million	0.5	-3.5	-1.5	-1.9	-1.1	-5.5
- %	2%	-14%	-38%	-48%	-4%	-18%
2009-10 to 2012-13						
- £ million	0.5	-1.2	-1.3	-1.5	-0.8	-2.7
- %	2%	-5%	-32%	-36%	-3%	-9%
2012-13 to 2016-17						
- £ million	-0.1	-2.4	-0.3	-0.5	-0.3	-2.8
- %	-0%	-9%	-9%	-17%	-1%	-10%

Chart 1



Source: page 28, 'State of the Economy – March 2012', Scottish Government.

Analysis of Tables 1a & b shows the change in spending power,

- from peak (2009-10) to the final forecast year (ie, 2016-17)
- from peak to 2012-13 (ie, the current financial year)
- from 2012-13 to 2016-17 (ie, to the final year outlined so far by H M Treasury)

Total DEL Budget

- the overall real terms cut between 2009-11 and 2016-17 is projected to be 18%, or £5½ billion;
- to the end of 2012-13, the real terms cut achieved has been around £2.7 billion, 48% of the total anticipated cut;

- between now (ie, 2012-13) and the end of the projected period, Total DEL still has to fall by another £2.8 billion in real terms.

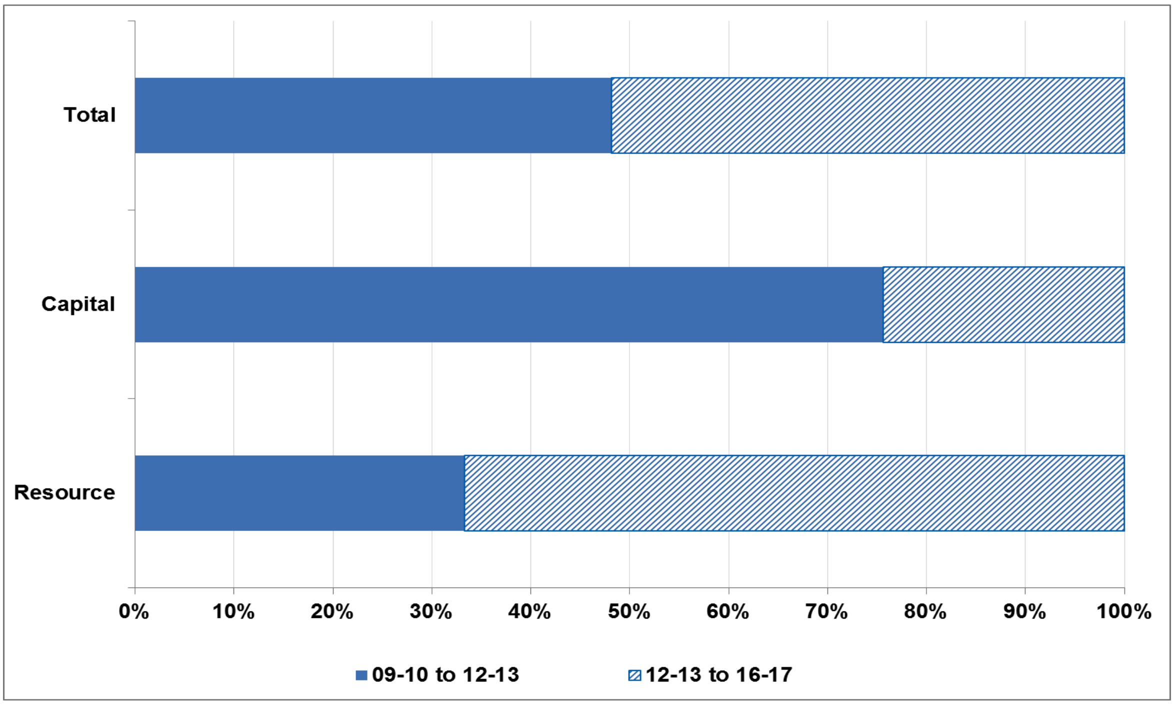
Resource DEL Budget

- the overall real terms cut between 2009-10 and 2016-17 is projected to be 14%, or £3½ billion;
- to the end of 2012-13, the real terms cut achieved has been around £1.2 billion, around one third of the total anticipated;
- between now (ie, 2012-13) and the end of the projected period, DEL resource still has still to fall by £2.4 billion in real terms.

Capital DEL Budget

- the overall real terms cut between 2009-10 and 2016-17 is projected to be 48%, or £1.9 billion;
- to the end of 2012-13, the real terms cut achieved has been £1.5 billion, just over three quarters of the total anticipated cut;
- between now (ie, 2012-13) and the end of the projected period, DEL resource still has still to fall by £0.5 billion in real terms;
- this front-loading of the cut to capital spending is in marked contrast to what is projected for Resource DEL (see Figure 1).

Figure 1: Share of DEL spending cuts already made and still to be delivered[2]



Net annual growth rates post devolution (1999-00 to 2016-17)

The real terms increase in Scottish Government spending between 1999-00 and 2009-10 is estimated to be around 60%, (ie, 5% a year). It is also estimated that this will be followed by

[2] In its 2012 Green Budget the IFS calculated that, for the period 2008-09 to 2016-17, "By the end of 2011-12, the (UK government's) plans imply that we will have experienced 73% of tax rises, 34% of the investment cuts, 12% of the benefits cuts, but just 6% of the cuts to non-investment spending on public services." Such a small degree of adjustment over this period for the UK is due to the fact that the IFS are looking at the cumulative loss against a peak level baseline. In other words while our analysis concentrates on the shift from peak (2009-10) to trough (2016-17) in Chart 1, the IFS are considering it in terms of the full shaded area shown.

an 18% real terms cut to 2016-17. As a result, Scottish total DEL spending will have grown by an average of just over 1½% a year over this 17 year period.

During this period, spending on Health in general, and the NHS in particular, grew faster than total DEL, and has been protected in real terms during the existing period of cuts. Consequently, it is reasonable to assume that this has translated into an underlying real terms growth rate of less than 1% a year for all the other spend areas over this 17 year period.

Such a low real terms average growth rate, which is likely to be even lower for the remainder of this decade, calls into question whether any increasing demand eg, from demographic shifts, can be met let alone allowing room for deliberate areas of policy expansion. This, in turn, highlights the likely increasing need for channelling future monies into high priority spending areas.

2. Extra UK welfare cuts

In the 2011 UK Autumn Statement the Chancellor of the Exchequer outlined Total Managed Expenditure (TME), Departmental expenditure Limits (DEL) and Annual Managed Expenditure (AME) spending plans beyond 2014-15, up to 2016-17. In the 2012 Budget the Chancellor further discussed these plans (see 'Annex A, Spending beyond 2014-15') and highlighted the impact it would have on DEL service spending totals if further, AME-related welfare cuts were not made.

It found that, without these benefit cuts, resource DEL spending reductions, on average, would be higher than projected in the later years (ie, -3.8% a year vs -2.3%). To keep future reductions at the same level as in earlier projections then extra welfare cuts, worth up to £10.5 billion of cash savings in 2016-17 (or £8.5 billion in real terms, 2012-13 prices), would be needed.

However, no specifics were given as to where these welfare cuts are to come from and leaks from within the government would suggest that there is an on-going internal debate as to whether further cuts of this size are viable. Indeed, controversy between the coalition parties over this may be one of the reasons that a full blown Spending Review in Autumn 2013 is likely to be delayed and one in 2014 curtailed in its coverage?.

The Office for Budget Responsibility (OBR) omits the impact of such welfare cuts from their analysis of budgetary changes up to 2016-17. They offer no explanation for why they choose to do this but it may well be connected to those discussed above.

Table 1 shows that the reductions in Scottish DEL resource (as shown in Table 1a) are ameliorated in 2015-16 and 2016-17, due to the now greater emphasis on restraining the UK welfare budget. However, in real terms, there is still a significant year-on-year cut in both years, and 2015-16 still experiences the second biggest annual % cut over the period 2010-11 to 2016-17.

It is also worth noting that this amelioration in the projected DEL resource budget reduction via additional welfare cuts could, in part at least, be offset by a greater demand for certain public services. This would be caused by welfare cuts having a knock on impact on these other services.

Table 1: Scottish DEL 2015-16 to 2016-17, adjusted for higher UK welfare savings £ billion (cash and 2010-11 prices)

	Projected years	
	2015-16	2016-17
DEL Resource – original calculations		
Cash	25.9	25.8
(£ change, yr-on-yr)	-0.3	-0.1
(% change)	-1.1%	-0.4%
2010/11 prices	22.9	22.3
(£ change)	-0.8	-0.6
(% change)	-3.5%	-2.8%
DEL Resource – welfare adjusted		
Cash	26.3	26.5
(£ change)	0.1	0.3
(% change)	0.2%	1.0%
2010/11 prices	23.3	22.9
(£ change)	-0.5	-0.3
(% change)	-2.2%	-1.5%

Sources: as Table 1A, plus H M Treasury Budget Report 2012, Annex A.

3. Protection of NHS spending

Thus far, in the tightening of budgets, both the Scottish and UK governments have chosen to protect the NHS resource budget. By and large, this has been done by keeping the NHS resource budget rising in cash terms but flat in real (inflation-adjusted) terms. It seems likely that some degree of protection will continue to be afforded to this budget beyond 2014-15.

The impact of this protection on the Scottish budget has two different dimensions:

- the first dimension is that any UK government protection of English NHS spending has a positive knock on effect in terms of Scotland receiving higher Barnett Consequential's based on these cash increases;

- the second dimension involves the extent to which Scottish NHS resources are protected. Protected could mean:
    - to rise in line with inflation (RPI or CPI) ie, 0% real,
    - to rise in line with real GDP ie, around +2 to 2½% real,
    - to rise in line with historic NHS increases, ie, around +4% real.[3]

Table 2 presents the impact of this protection in terms of what we already know, up to 2014-15, and projecting forward to 2016-17, based on the assumption that NHS funding remains flat in real terms.[4]

[3] Potentially the NHS budget need not be protected in this way. The Welsh Government, for example, has decided that the Welsh NHS should also take a share of the cuts.

[4] Figures are only given from 2011-12 onwards as a consistent NHS line before this is not available.

Table 2: Scottish Resource DEL 2009-10 to 2016-17, split NHS and non-NHS spend £ billion (cash and 2010-11 prices)

	Outturn	Current	Forecast		Projected	
	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
<u>DEL Resource Total</u>						
Cash	25.6	25.9	26.1	26.2	25.9	25.8
(£ change, yr-on-yr)		0.3	0.2	0.2	-0.3	-0.1
(% change)		1.2%	0.7%	0.6%	-1.1%	-0.4%
2010/11 prices	25.0	24.7	24.2	23.8	22.9	22.3
(£ change, yr-on-yr)		-0.4	-0.4	-0.4	-0.8	-0.6
(% change)		-1.4%	-1.8%	-1.8%	-3.5%	-2.8%
<u>DEL Resource NHS</u>						
Cash	8.65	8.86	9.13	9.39	9.63	9.87
(£ change, yr-on-yr)		0.2	0.3	0.3	0.2	0.2
(% change)		2.5%	3.0%	2.8%	2.5%	2.5%
2010/11 prices	8.46	8.44	8.49	8.52	8.52	8.52
(£ change, yr-on-yr)		0	0	0	0	0
(% change)		-0.2%	0.5%	0.3%	0%	0%
<u>DEL Resource non-NHS</u>						
Cash	16.8	16.9	17.0	16.9	16.8	16.3
(£ change, yr-on-yr)		0.1	-0.1	-0.1	-0.5	-0.3
(% change)		0.6%	-0.6%	-0.6%	-3.1%	-2.1%
2010/11 prices	16.59	16.23	15.74	15.27	14.43	13.79
(£ change, yr-on-yr)		-0.3	-0.5	-0.5	-0.8	-0.6
(% change)		-2.1%	-3.0%	-3.0%	-5.5%	-4.5%

Sources: as Table 1A.

Table 2 shows that, for budgets falling within the category of 'non NHS DEL resource':

- there is a cash terms reduction in each year after 2012-13, ie, the current financial year;
- there is a real terms reduction of between 2% to 5½% annually between 2012-13 and 2016-17;
- the reduction is highest in the last two years shown, ie, 2015-16 and 2016-17.

Clearly if the NHS were to be given even more protection, say moving towards its historical average increase of 4% a year, then the cuts to non NHS resource budgets would be even larger.

4. Prospects beyond 2016-17

The Scottish Government's outlook (see Chart 1) suggests that 2016-17 will be the real terms trough point for the Scottish DEL budget. However, this scenario is based on the latest forecasts by OBR of UK growth and expenditure taken from their Long Run paper of July 2011[5]. These figures show Total UK government expenditure to be flat as a % of GDP, and so rising in real terms. However, the projections were made prior to the Autumn Statement downgrades for expenditure in 2015-16 and 2016-17. Hence, the position may change again, depending on how UK GDP growth turns out and on what UK government policy changes are made as a result of any such higher or lower growth.

[5] OBR, 'Fiscal Sustainability Report', July 2011.

In a recent report[6], the Institute of Fiscal Studies (IFS) and the Nuffield Trust assume that total public spending, post 2016-17, increases in line with real GDP, that is at 2.1% a year (equivalent to 4.6% in cash terms). As debt interest spending is a little lower than this it allows for public service spending to rise by 2.2% p.a.

Using this assumption, and if NHS spend were again to be protected in real terms (i.e. +2.1% a year), this would allow for 2.3% a year non-NHS growth.

However, in reality NHS claims on faster growth once funds are available are likely to be strong, and have strong political support. If this resulted in a return to the UK long term average real terms rise, of 4% a year, then non-NHS spend growth would fall to 1.5% a year.

Due to Scotland's higher DEL baseline spend per head, the 2.3% growth rate at the UK level is likely to be reduced to 2% a year for Scotland beyond 2016-17. [7]

Such a post 2016-17 timescale is well beyond the date of a Scottish referendum on its constitutional future which could result in independence or greater fiscal autonomy, and which could, in turn, impact on these figures. Equally, with a UK government election due in, or before, 2015, then the future fiscal approach at this level is also uncertain.

Overall, looking this far forward is imprecise in terms of annual changes, however, it does give some insight into the likely funding landscape in general terms over the planning period for most public authorities.

Overview

As has been discussed above, the future fiscal position is quite complicated, with the variations in outcome dependent on: the degree of protection afforded to NHS spending; and the degree to which further cuts to the welfare budget can be found.

For example, for 2015-16 to 2016-17, the non NHS resource cuts could vary from:

- 1½ to 2%, assuming welfare savings and no special treatment for the NHS;
- 4½ to 5½ %, assuming no welfare savings and continued protection, ie, flat in real terms, of NHS resource spending;
- with the final outcome being dependent on future decisions to be taken by the UK and Scottish governments.

However, even this range does not properly encompass the potential for further change, probably most on the downside such economic and fiscal events change further.

Beyond 2016-17 any projections are further complicated by:

- the implications of Dilnot/Social Care reform;
- the pace at which NHS spending picks up;
- the rate of growth of GDP.

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[6] IFS, (2012) NHS and social care funding: the outlook to 2021/22, IFS, July 2012.

[7] While the same increases in spending per head in spending will emerge from the use of the Barnett Formula, as Scottish spend per head is higher than in the UK, then this results in a lower %age terms rise.

This makes predictions particularly difficult to make but the prospects for non-NHS and non-Social Care budgets are not looking good.

A landscape and horizon of continuing financial challenges

The above analysis highlights a fiscal landscape, stretching into the horizon, of continuing financial challenges.

Indeed it could be argued that such challenges will intensify as (i) the low hanging fruit, in terms of efficiency savings, will already have been picked and (ii) at present, 2015-16 and 2016-17 may prove to be two of the most difficult years to negotiate in terms of the Resource budget.

The main 'known' in this landscape is the on-going squeeze on public funds, especially when rising demands are also taken into account.

The main 'unknown' is the degree to which economic growth will return. The more growth there is then the more flexibility there will be with respect to future budgets, but at present the potential source(s) of such improved growth are unclear.

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20th September 2012