CPPR Briefing Paper
14th February 2012

Centre for Public Policy for Regions

Projections of the Scottish Government's Budget (DEL-based) to 2017-18

This Briefing Paper projects the Scottish Departmental Expenditure Limit (DEL) Budget to 2017-18, in light of the UK Government's 2012 Autumn Statement and the associated Economic and Fiscal Outlook (EFO) by the Office for Budget Responsibility (OBR). It also takes into account the Institute for Fiscal Studies' (IFS) latest (2013) Green Budget report.

Tables 1 and 2, below, estimate the change in the Scottish DEL Budget, in both cash and real terms, from its peak in 2009-10 to 2017-18 (see Annex for more detail).

Table 1: Scottish DEL 2009-10 to 2017-18, £ billion (cash and 2012-13 prices)

	Out-turn years			Forecast years			Projected years		
	09-10	**10-11**	**11-12**	**12-13**	**13-14**	**14-15**	**15-16**	**16-17**	**17-18**
DEL Resource									
Cash	**25.4**	**25.9**	**25.6**	**25.9**	**26.1**	**26.1**	**26.2**	**25.9**	**25.4**
(£ change)		0.5	-0.4	0.3	0.2	0.1	0.1	-0.4	-0.5
(% change)		2.1%	-1.4%	1.2%	0.7%	0.3%	0.4%	-1.3%	-1.8%
2012/13 prices	**27.4**	**27.2**	**26.2**	**25.9**	**25.6**	**25.1**	**24.7**	**23.9**	**23.0**
(£ change)		-0.2	-1.0	-0.3	-0.3	-0.5	-0.4	-0.8	-0.9
(% change)		-0.8%	-3.6%	-1.2%	-1.3%	-1.7%	-1.7%	-3.3%	-3.8%
DEL Capital									
Cash	**4.0**	**3.3**	**2.8**	**2.7**	**2.5**	**2.7**	**2.5**	**2.5**	**2.6**
(£ change)		-0.7	-0.5	-0.1	-0.2	0.1	-0.2	0.0	0.1
(% change)		-16.8%	-16.1%	-1.8%	-6.5%	5.1%	-5.6%	1.5%	2.0%
2012/13 prices	**4.3**	**3.5**	**2.8**	**2.7**	**2.5**	**2.6**	**2.4**	**2.4**	**2.4**
(£ change)		-0.8	-0.6	-0.1	-0.2	0.1	-0.2	0.0	0.0
(% change)		-19.2%	-18.0%	-4.2%	-8.3%	3.0%	-7.6%	-0.6%	0.0%
Total DEL									
Cash	**29.4**	**29.2**	**28.4**	**28.6**	**28.6**	**28.8**	**28.7**	**28.4**	**28.0**
(£ change)		-0.2	-0.9	0.3	0.0	0.2	-0.1	-0.3	-0.4
(% change)		-0.5%	-3.0%	0.9%	0.0%	0.7%	-0.3%	-1.1%	-1.5%
2012/13 prices	**31.7**	**30.7**	**29.0**	**28.6**	**28.1**	**27.7**	**27.1**	**26.3**	**25.4**
(£ change)		-1.0	-1.6	-0.4	-0.6	-0.4	-0.6	-0.8	-0.9
(% change)		-3.3%	-5.2%	-1.5%	-1.9%	-1.3%	-2.2%	-3.0%	-3.4%

Sources: Figures for 2011-12 to 2014-15 are consistent with the Treasury DELs-based Scottish Budget figures, as published by the Financial Scrutiny Unit (FSU) of SPICe; for 2015-16 to 2017-18 figures are calculated by CPPR (see Annex).

Table 2: Changes in Scottish DEL (cash & 2012-13 prices)

	DEL Resource		DEL Capital		DEL Total	
	Cash	2012-13	Cash	2012-13	Cash	2012-13
2009-10 to 2017-18						
- £ billion	0.0	-4.4	-1.4	-1.9	-1.4	-6.3
- % change	0%	-16%	-34%	-45%	-5%	-20%
2009-10 to 2012-13						
- £ billion	0.5	-1.5	-1.3	-1.6	-0.8	-3.1
(share of total cut)		34%		81%		49%
2012-13 to 2017-18						
- £ billion	-0.5	-2.9	-0.1	-0.3	-0.6	-3.2
(share of total cut)		66%		16%		50%

Analysis of Tables 1 and 2 shows the change in spending power,
- from peak (2009-10) to the final year forecast by OBR (2017-18)
- from peak to 2012-13 (ie, the present financial year)
- from 2012-13 to 2017-18.

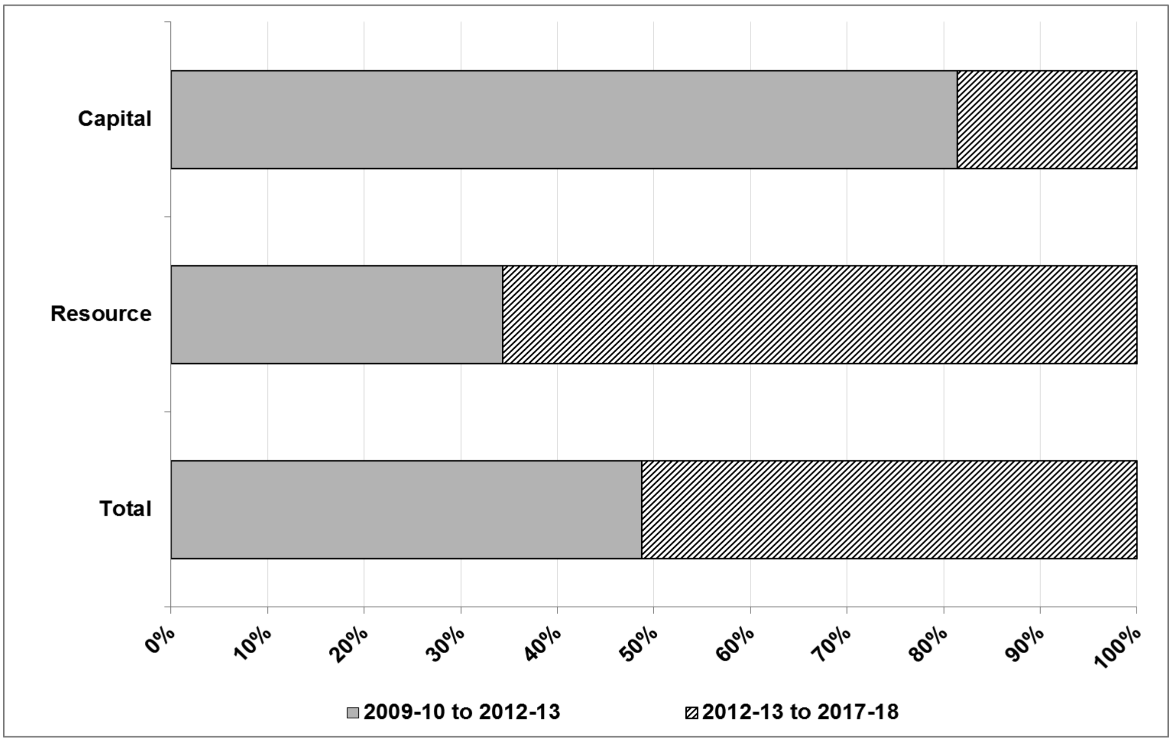
Resource DEL Budget
- the overall real terms cut between 2009-10 and 2017-18 is projected to be 16%, or £4.4 billion;
- to the end of 2012-13, the real terms cut achieved has been £1.5 billion, 34% of the total anticipated;
- between now (ie, 2012-13) and the end of the projected period, DEL resource still has still to fall by £2.9 billion in real terms;
- by individual years, 2017-18 is shaping up to be the worst, followed by 2011-12 and then 2016-17;
- It should be noted that there are cash, as well as real, terms falls now projected for both 2016-17 and 2017-18. As a result, whilst by 2017-18 the cash position for DEL resource is unchanged compared to 2009-10, this hides a slowly rising trajectory to 2015-16, which is then followed by year-on-year cash reductions. Careful planning of DEL resource spending will be needed should this DEL resource profile emerge.

Capital DEL Budget
- the overall real terms cut between 2009-10 and 2017-18 is projected to be 45%, or £1.9 billion;
- to the end of 2012-13, the real terms cut achieved has been £1.6 billion, around 81% of the total anticipated cut;
- between now (ie, 2012-13) and the end of the projected period, DEL capital still has to fall by £0.3 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);
- by individual years, 2010-11 and 2011-12 were the worst but 2013-14 and 2015-16 are also shaping up to require quite large cuts.

Total DEL Budget
- the overall real terms cut between 2009-10 and 2017-18 is projected to be 20%, or £6.3 billion;

- to the end of 2012-13, the real terms cut achieved has been around £3.1 billion, around half of the total anticipated cut;
- between now (ie, 2012-13) and the end of the projected period, Total DEL still has to fall by £3.2 billion in real terms;
- over the time period as a whole, the declines seen in 2010-11 and 2011-12 are expected to be the worst, but those anticipated for 2016-17 and 2017-18 are also looking like they will contain significantly large cuts.

Figure 1: Share of DEL spending cuts already made and those still to be delivered



In comparison to the position at the time of the UK Government's March 2012 Budget, the main changes that have taken place are:

- the addition of capital-related Barnett consequentials in 2013-14 and 2014-15, that are not maintained thereafter, which results in a much steeper fall in UK and Scottish DEL capital in 2015-16 than before;
- some offsetting DEL resource cuts, mainly seen in 2014-15, resulting from negative Barnett consequentials caused by across-the-board[1] UK resource cuts of 1% in 2013-14 followed by a 2% cut in 2014-15. Again, these are assumed by OBR not to be maintained thereafter, resulting in a lower fall in UK and Scottish DEL resource in 2015-16 than before;
- up to 2014-15 there is an assumption of higher Departmental underspends which is not extended beyond 2014-15;
- real terms cuts are not as steep as before in most years as projected inflation has been revised down post 2012-13;
- overall, the real terms fillip from lower inflation has been countered by an extension of the real terms cuts by another year, to 2017-18.

[1] These cuts do not apply in all areas, eg the NHS is excluded.

Probably the biggest effect of these changes is that there is now a second wave of cuts emerging post 2014-15, seen at both the UK level (see Table 3) and at the Scottish level (see Table 1). This is particularly true for resource budgets, as the capital cuts remain front-loaded.

Table 3: UK DEL Budget: average annual growth rates

	2010-11 to 2014-15	2014-15 to 2015-16	2015-16 to 2017-18
UK DEL	-2.8%	-2.4%	-3.4%
- Resource DEL	-2.3%	-1.7%	-3.7%
- Capital DEL	-5.8%	-8.1%	-0.5%

Source: IFS Green Budget Table 6.1

IFS Green Budget 2013

The IFS's Green Budget 2013, published last week, highlighted the following important issues:

- Oxford Economics, who provided macro-economic forecasts, had a more optimistic central scenario than the OBR (see Chapter 5). This is due to its belief that more spare capacity exists in the UK economy, resulting in higher future trend growth. If this is correct, the knock on impact for total planned fiscal consolidation would be to reduce it from 9.2% of national income (2010-11 to 2017-18) to 8%, worth £19 billion. Under Oxford Economics' 'optimistic' scenario, this fiscal consolidation benefit rises to £25 billion. However, Oxford Economics also produce a pessimistic scenario, which projects a growth rate that is worse than the OBR's central estimate. These Oxford Economics alternative scenarios have not been used by the IFS to project forward UK Departmental public spending plans. Instead, the IFS projections (see Chapter 6) are based on the OBR's December 2012 projections.

- The IFS provide two scenarios for how the UK Departmental cuts might be distributed[2]. Both assume that the NHS, Schools and International Aid budgets continue to be protected. The first scenario then assumes that all other Departments will experience cuts in line with those they have previously experienced (ie, the size of relative cuts will be consistent with those already experienced), while the second scenario assumes equality in the percentage terms cut being applied to all the non-protected Departments.

Emerging issues

It is worth reiterating at this point that the Scottish DEL projections in Table 1 are based on the OBR's projections, which assume a continuation of current UK government policy post 2015-16. Whilst these policies could change, there continues to be no sign of any such

[2] In addition, the Financial Times recently (05/02/13) published its own research on the size of the cuts, by Department, up to 2017-18. This showed a figure for Scotland of around -20%, 2010-11 to 2017-18, roughly in line with the estimates shown in Table 1 of the report.

[2] This pay policy only applies to those public service workers whose terms are decided by the Scottish Government. In fact this is a relatively small number as it excludes, for example, most Local Government and NHS staff.

radical shift in policy being made and hence it seems prudent to view the OBR's current projections as a 'central' forecast.

Assuming that further cuts of this scale are likely, there are two principal worries that emerge from these projections: first, the length of the austerity currently being proposed and; second, the profile of this austerity push, in particular the emergence of a 'second wave' of cuts, post 2014-15.

This second wave effect is likely to emerge at a time when the public and budget holders may have anticipated a softening of, or even an end to, budget cuts. If this translates into greater public resistance to service reductions and/or a resurgence in wage claims, then accommodating these budget reductions could be even more difficult than the first wave proved to be. This would be particularly true if expectations are not effectively managed. This suggests a need for the continued public assessment of policy and budget measures that could help reduce these budget pressures.

At present, the implications of this central OBR forecast for Departmental budgets is drastic. For example, the IFS calculated that, at the UK level, continued protection of the NHS, schools and overseas aid would lead to real cuts in unprotected areas like transport, police, defence and Local Government, of over 30% since 2010-11. The IFS expressed the view that the realisation of overall cuts of this magnitude "*looks close to inconceivable*". The overall position is unlikely to be very different in Scotland. A 20% real terms cut in total DEL would mean close to a 30% real terms cut for non-NHS budgets.

In order to reduce, or eradicate, the ratcheting-up of austerity post 2015-16 described above, there are a number of policy actions that could be undertaken by the UK and Scottish Governments, some of which help as a whole and some of which could redistribute the pain of such adjustment within the overall budget.

Potential alternatives at the UK level to relieve the pressure on Scottish DEL

<u>Raising Taxes</u>

Potentially, revenues from any (existing or new) tax source could be raised by increasing rates, amending bandwidths, or reducing allowances.

In their Green Budget the IFS outline the extent to which various taxes would need to be raised in order to reduce the implied DEL cuts. For example, increasing the standard rate of VAT by 1 percentage point raises £5 billion. It also highlights a number of improvements that could be made to the existing tax system and suggests that reform of existing taxes should be undertaken before considering the introduction of any new ones. However, whilst a more radical change to the UK tax system may offer possible options, it is unclear just how quickly they could be introduced.

<u>Increasing Borrowing</u>

An alternative to such extended spending cuts would be increasing the level of borrowing. However, as this would be a U-turn in relation to the current strategy of the UK coalition government it seems unlikely at present that this would be undertaken on a large scale.

Finding further Benefits cuts

There may be some relief to the real terms DEL cuts currently implied if further cuts can be made in the Benefits budget (or indeed in any other non-Barnett spending area like Defence, assuming this is deemed politically deliverable).

At the time of the 2012 Budget it was anticipated that up to £10 billion of extra Benefits cuts would be found by 2016-17. At the 2012 Autumn Statement the UK Government delivered £3.6 billion of these cuts by 2015-16 but there were also strong political hints given that they would go no further.

If they were to go further, then the IFS's 2013 Green Budget (see Chapter 8) considers where the greatest scope for further savings lies, this includes extending or deepening the degree of below inflation uprating of benefits, including applying this to pensioners' benefits.

Potential alternatives at the Scottish level to relieve the pressure on Scottish DEL

Extended and/or deeper wage restraint

Wages account for well over 50% of all spending in the Scottish public sector. While there has been a pay freeze policy in operation since 2010-11 for all but the lowest paid, the Scottish Government's Draft Budget for 2013-14 now incorporates a 1% increase for public sector workers[2], excluding those earning over £80,000 a year.

This loosening in pay policy may now make it much harder to re-introduce pay freezes in the future and indeed it may offer the opportunity to those who feel they can, to press for further loosening of pay policy in future budget rounds. At 1% this means that potentially around an extra £200 million will need to be given over to higher wages every year.

However, some potential for wage savings may emerge over the coming years. Until recently teachers, NHS workers and the police benefited from three year wage settlements that were respected in spite of the budget cuts. This was in contrast to public service workers not covered by three year settlements (eg, many local government workers) or where such settlements were abandoned (eg, non-senior civil servants).

Hence, it would appear that much of the protection of the NHS and Schools resource Budgets will have gone on rising average wage costs, with any savings emerging from staff cuts. This conclusion is backed up by evidence shown in Chapter 6 of the IFS's 2013 Green Budget as well as Scottish evidence[3] suggesting that wages have been rising faster in the NHS than in other areas of the public service.

Given this protection of some public sector wages over others in recent years there may now be a case for some rebalancing in wage restraint across the public sector to be made in future years, and which could also allow for significant savings.

Ending protection of the NHS resource budget

[3] See ISD Scotland's 'Summary of Health Service Costs' where 5 year comparator tables suggest that, between 2010 and 2012, Hospital sector staff costs rose as a % of total costs, while at the same time staff numbers were falling.

Protection given to the resource side of the NHS budget thus far means that non-NHS resource budget cuts are much larger than the average shown in Table 1. At present it is unclear the degree to which such protection will be maintained.[4]

Thus far Scotland has, by and large, followed the UK's lead in protecting NHS resource spend, by ring-fencing NHS Barnett consequentials[5]. This is not the case elsewhere. In Wales, for example, such full protection has not occurred.

Potential for making savings from the NHS wage bill (relative to what has been awarded in recent years) has already been discussed. However, further scope for savings may also emerge from a study of what actions were taken by the Welsh Government in order to rein in such costs.

Clearly, in light of last week's Mid-Staffordshire NHS Trust report, the impact of any such budget savings would need to be carefully investigated, but given the size of increase to this budget in the past decade some scope for greater financial efficiency seems possible.

Increase revenues and/or borrowing

Raising its own revenues is another route open to the Scottish Government. It could take the form of: ending the council tax freeze; further increase non-domestic rates; start charging again for current free services (eg, bus passes, personal and nursing care, eye tests, prescriptions); raise charges on students; raise water charges (so further lowering its loans to Scottish Water); re-introduce tolls on bridges; etc.

In the time frame being considered, the Scottish Government will also be able to use its new borrowing powers and levy new taxes.

The alternatives to further deep public service cuts are not politically palatable, but then neither are the cuts themselves. Big choices will need to be made involving significant trade-offs between winners and losers. It would be best for these choices to be made in light of a wider popular discussion, as opposed to simply being thrashed-out inside the Scottish and UK Parliaments amongst the political parties.

Conclusions

The above analysis highlights a landscape of continuing financial challenges. Indeed on the Resource Budget side (excluding the NHS) it is clear that most of the pain still lies ahead, and at a time when the recent pay freeze has come to an end.

This implies that further debate over the basics of how public money is spent in both Scotland and the UK is essential, incorporating discussions around:

[4] A similar argument applies in other areas that are 'protected' in some way, e.g. schools and Higher Education resource DEL.

[5] It seems likely that the UK approach to NHS resource spending will continue to have a strong bearing on what happens in Scotland. Given this, it is interesting to follow how the debate in this area has been proceeding in England. If anything this debate has been dominated by arguments along the lines that the continued restriction of NHS budgets to 'inflation only' rises is not tenable in the long run and that 'above inflation' rises will need to be re-introduced sooner rather than later. If this were to occur, within the existing public funding envelope, then clearly there would be a knock on, negative, impact on non-NHS resource budgets.

- health spending as a whole;
- benefit payments to pensioners;
- payments for, or greater targeting of, public services currently free at the point of use.

It seems likely that some of the more basic reforms to the State that have been seen up to now in countries like Ireland (eg, in terms of increased charges for services and greater targetting of benefits) will need to be addressed here too. This need for greater re-evaluation of priorities and policies is reinforced by the likely future profile of real terms cuts which, as mentioned earlier, shows a second wave of rising cuts starting after 2015-16.

There is also an urgent need for more debate and more clearly stated rationale for greater priority being given to:

- the NHS over social work services;
- Higher Education over Further Education;
- freezing of council tax over keeping business rates low[6];

As both the NHS and Higher Education are large budgets, if such protective policies were to continue indefinitely it would have very serious implications for other budgets. At some point the perceived advantages of such protection are likely to be outweighed by the negative implications of increasingly large cuts to other budgets.

The next opportunity for a more fundamental review of public service practice and provision will come in 2013, when the UK Government will undertake a spending review. This will result in details of departmental spending plans for 2015-16[7], which will be announced during the first half of 2013. In response to this, the Scottish Government will presumably undertake a similar exercise, either in parallel or once Scotland's Barnett consequentials become known.

It would be unfortunate if both UK and Scottish Governments did not use this opportunity to outline what their longer term proposals were to deal with deeper cuts or alternative difficult decisions. However, with both a UK election and the independence referendum looming it seems unlikely that this will be the case.

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14th February 2013

[6] As with the English and Scottish Government's protection of NHS funding, it should be noted that the Welsh Government has not followed the example of freezing Council Tax, which has continued to rise at between 2-3% a year.

[7] It is unusual for a Spending Review to only cover one financial year. It may be the case that this is being done in order to avoid conflict within the existing UK coalition government, especially as it faces deepening DEL resource cuts post 2015-16.

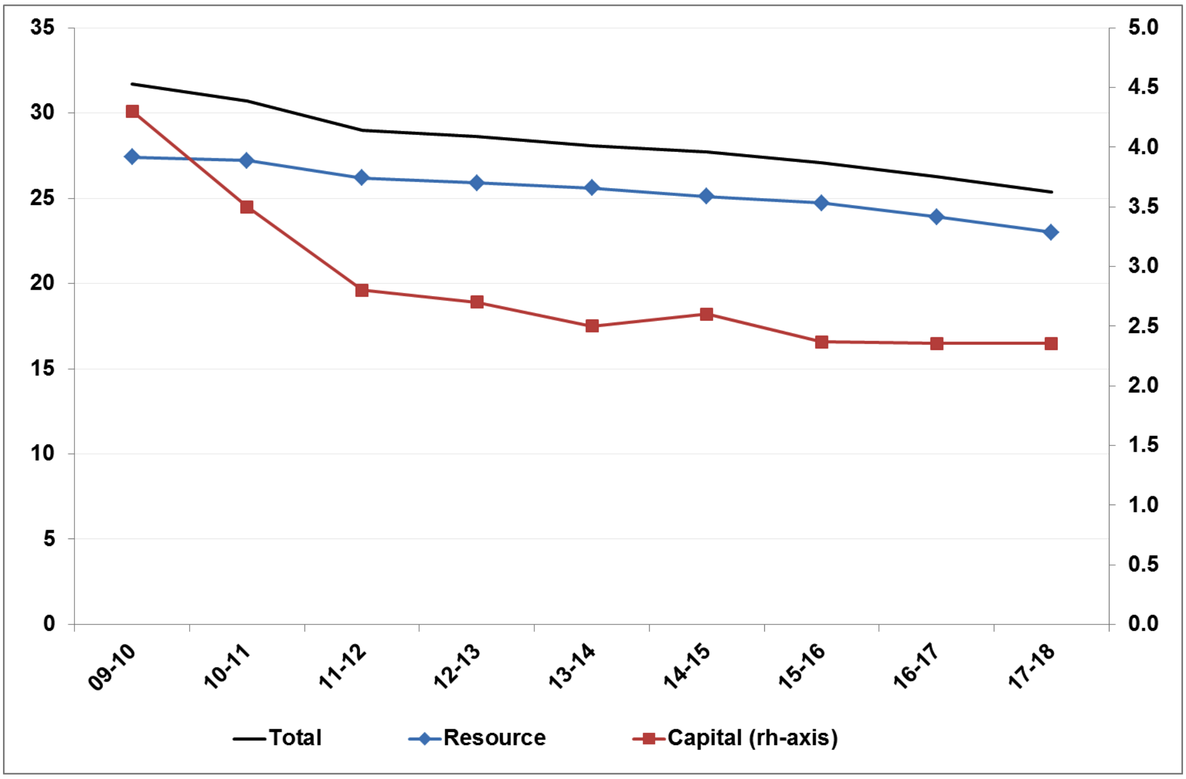
Annex

CPPR's projection methodology

For 2015-16 to 2017-18 figures for the Scottish budget are calculated using UK resource and capital DEL spending growth rates from Table 4.16 of OBR's December 2012 Economic and Fiscal Outlook.

CPPR has converted these growth rates into cash terms, then adjusted for a higher relative spend per head in Scotland, in order to take into account the impact of the Barnett Formula. The growth rates are then adjusted back into real terms changes before projecting the figures shown in Table 1. The exact future Scottish DEL budget will depend on the final split of UK cuts between Barnett and non-Barnett related cuts.

Scottish DEL 2009-10 to 2017-18, £ billion (2012-13 prices)



Sources: as for Table 1.