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**THE SCOTTISH EXECUTIVE'S BUDGET: 2007-08 TO 2010-11**  
**Analysis of Spending Plans of Political Parties**

**Background report**

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## 1. DETAILED ANALYSIS OF SCOTTISH EXECUTIVE BUDGET

*The Scottish Executive's forecast expenditure for the period 2008-09 to 2010-11*

Key to estimating the size of the Scottish Executive's future expenditure is the growth rate that is likely to apply to the 2007-08 baseline figures. The IFS suggests that the Chancellor is likely to allow spending on capital items to rise by more than spending on operating costs (ie, capital and resource DEL respectively). As Table 1 shows, the IFS estimates total departmental spending will increase annually at around 2%<sup>i</sup> in real terms, with capital DEL rising at 2.7% pa and resource DEL by only 1.9% pa between now and 2010-11. Whilst this does imply real growth, Table 1 illustrates how relatively difficult the next three years will be by comparing this rate of growth with what was experienced in Scotland in the last two spending review periods.

**Table 1: Annual percentage increase in Scottish Executive capital<sup>ii</sup> & resource spending**

	<b>SR2002<sup>iii</sup> 03-04 to 05-06</b>	<b>SR2004 05-06 to 07-08</b>	<b>Forecast CSR07 07-08 to 10-11</b>
<b>Nominal prices</b>			
DEL Resources	8.0%	4.7%	3.9%
DEL Capital	14.2%	34.0%	4.7%
Total DEL	8.5%	7.4%	4.0%
<b>07-08 prices</b>			
DEL Resources	5.5%	2.1%	1.9%
DEL Capital	11.5%	30.7%	2.7%
Total DEL	5.9%	4.7%	2.0%

*Note: All forecasts assume an inflation rate of 2% pa*

*Source: Scottish Executive (2006a); IFS (2007); own estimates*

In the SR2002 review overall spending rose by 8.5% pa in cash terms and 5.9% pa excluding inflation, almost 3 times the real rate of growth forecast for the CSR2007 period. Even comparing the forecasts with the rates experienced in the most recent spending review period (ie, SR2004) the forecast growth rate is less than half the annualised real rate.

The forecast growth rates for resource DEL will continue to be squeezed. At 1.9% in real terms, this is marginally lower than the annual rate achieved in SR2004 and almost three times lower than the real annual rate of growth achieved in SR2002.

Whilst capital DEL is forecast to grow almost 1.4 times faster than resource DEL (2.7% compared to 1.9%), it nevertheless implies a significant relative real decline when compared to the annual real increases in either SR2004 or SR2002. This must have serious implications for the post election administration.

What does applying these IFS growth rates<sup>iv</sup> mean for the quantum of expenditure that might be allocated across Scotland's public services? Tables 2 and 2a outline the forecasts for DEL (both in 2007-08 prices as well as in cash terms) to 2010-11. It is assumed 2007-08 is the baseline year and that the Scottish Executive commits to the same division of the growth of expenditure between resource and capital expenditure as the UK government.

**Table 2: Forecast capital and resource spending, 2008-2011 (£ million, 2007-08 prices)**

	Baseline 2007-08	Forecasts		
		2008-09	2009-10	2010-11
<u>Nominal prices</u>				
DEL Resources	23,443	24,366	25,326	26,323
DEL Capital	3,329	3,488	3,653	3,827
<b>Total DEL</b>	<b>26,773</b>	<b>27,854</b>	<b>28,979</b>	<b>30,150</b>
<u>07-08 prices</u>				
DEL Resources	23,443	23,889	24,343	24,805
DEL Capital	3,329	3,419	3,512	3,606
<b>Total DEL</b>	<b>26,773</b>	<b>27,308</b>	<b>27,854</b>	<b>28,411</b>

Source: Scottish Executive (2006a); IFS (2007); own estimates

**Table 2a: Forecast incremental capital and resource funds, 2008-2011 (£ million, 2007-08 prices)**

	Baseline 2007-08	Forecast incremental increase			Incremental total
		2008-09	2009-10	2010-11	
<u>Nominal prices</u>					
DEL Resources	23,443	923	960	997	2,880
DEL Capital	3,329	158	166	174	498
<b>Total DEL</b>	<b>26,773</b>	<b>1,081</b>	<b>1,125</b>	<b>1,171</b>	<b>3,378</b>
<u>07-08 prices</u>					
DEL Resources	23,443	445	454	463	1,362
DEL Capital	3,329	90	92	95	277
<b>Total DEL</b>	<b>26,773</b>	<b>535</b>	<b>546</b>	<b>557</b>	<b>1,639</b>

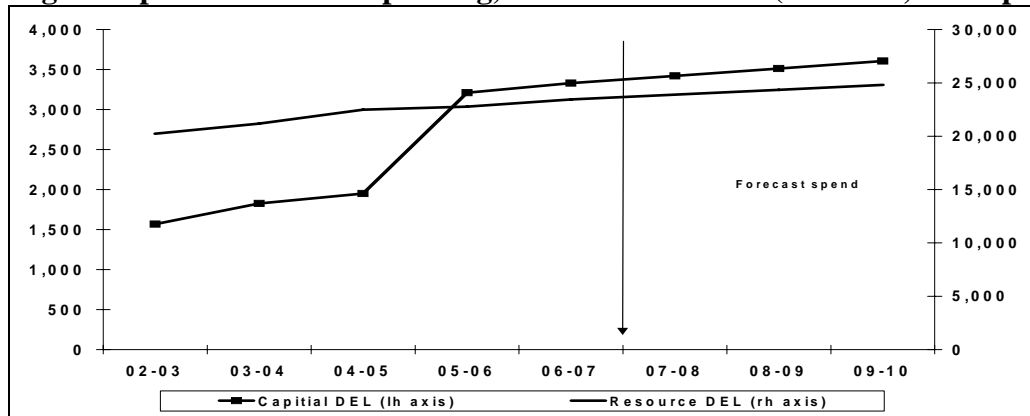
Source: Scottish Executive (2006a); IFS (2007); own estimates

Total DEL is forecast to rise to around £30,150 by 2010-11 or just over £28,410 million in 2007-08 prices. This provides an additional spending capacity of almost £3,400 million in cash terms and around £1,640 million in 2007-08 prices over the period. Under these conditions, spending on capital investment is forecast to rise by almost £500 million (or £280 million in 2007-08 prices) whilst spending on operating activities is forecast to grow by £2,880 or £1,360 million in 2007-08 prices.

## 2. COMPARISON WITH EARLIER SPENDING TRENDS

To put these forecasts into context, Fig 1 shows the trend in spending on capital and resource budgets since 2003-04.

**Fig 1: Capital & resource spending, 2003-04 to 2010-11 (£ million, 07-08 prices)**



*Note: the step change in capital DEL is caused by the reclassification of grants to the private sector and introduction of additional rail funding following the transfer of powers to Holyrood.*

*Source: Scottish Executive (2006a); IFS (2007); own estimates*

Whilst the chart shows continued rising trends in spending, it also highlights the slow down in the rate of growth (as shown in Table 1 above) since the 2003-04 spending review period. This would suggest significant challenges facing any new administration. Those who might wish to make radical policy changes will have limited financial room to do so without having an effect on current spending allocations. However, even maintaining current service delivery may be difficult where costs are rising faster than general inflation and/or where demand continues to rise.

### 3. DEPARTMENTAL ALLOCATIONS

By looking at how this forecast increase in DEL might be allocated across the various Scottish Executive portfolios<sup>v</sup> the full extent of the challenge facing the post election administration becomes clear.

Though there are clearly very many ways in which the funds could be allocated, this paper proposes two possible scenarios. Scenario I assumes the total forecast increase in DEL outlined in Table 2a is allocated evenly across all spending departments whereas scenario II assumes the Scottish Executive continues to favour spending on health and education, allocating a disproportionate amount of available funds to these two spending areas. Table 3 summarises the percentage increases for both scenarios.

In scenario I, the percentage increases in expenditure vary across portfolios as a result of the different ratio of capital to resource spending across portfolios. In addition, in scenario II the non-favoured portfolios experience a significantly lower real rate of growth because of the disproportionate share of the total Scottish Executive budget that is accounted for by health and education; health consumes almost 40% of total DEL spending in 2007-08 whilst education accounts for around 20%.

**Table 3: Annual average real increase in spending between 2008-09 and 2010-11 (%)**

	Scenario I	Scenario II
Overall real increase in DEL pa	2%	2%
Increase in DEL capital pa	2.7%	n/a
Increase in DEL resource pa	1.9%	n/a
Increase in health spending pa	2%	3.85%
Increase in education spending pa	2%	2.5%
Increase in non-health & education portfolios pa	2%	0.05%

Source: IFS (2007); own estimates

### Scenario I:

#### Incremental expenditure allocated across all portfolios on a on a pro-rata basis

Scenario I assumes all portfolios receive a pro-rata share of the increase, namely, a 1.9% real increase pa for resource DEL and a 2.7% pa real increase in capital DEL (see Tables 4 and 4a).

**Table 4: Scenario I -Forecast increase in DEL by portfolio, £ million (nominal prices)**

	Baseline 07-08	08-09	09-10	10-11	Average real increase pa
Health & Community Care	10,247	10,655	11,079	11,520	1.94%
Finance & Public Sector Reform	7,176	7,462	7,759	8,068	1.94%
Enterprise & Lifelong Learning	2,725	2,836	2,951	3,072	2.04%
Transport	1,825	1,903	1,985	2,070	2.25%
Communities	1,320	1,376	1,435	1,496	2.20%
Justice	1,132	1,178	1,226	1,276	2.03%
Environment & Rural Affairs	915	954	994	1,036	2.19%
Education & Young People	642	668	695	723	2.02%
Tourism, Culture & Sport	311	323	336	350	1.97%
Scottish Executive Administration	261	272	282	294	1.94%
Scottish Parliament & Audit Scotland	107	111	116	120	1.93%
Crown Office	101	105	109	113	1.95%
Food Standards Agency	11	11	12	12	1.91%
<b>TOTAL</b>	<b>26,773</b>	<b>27,854</b>	<b>28,979</b>	<b>30,150</b>	<b>2.00%</b>

Source: Scottish Executive (2006a); IFS (2007); own estimates

**Table 4a: Scenario I -Forecast incremental increase in DEL by portfolio, £ million (nominal prices)**

	Baseline 07-08	08-09	09-10	10-11	Incremental Total
Health & Community Care	10,247	408	424	441	1,273
Finance & Public Sector Reform	7,176	286	297	309	891
Enterprise & Lifelong Learning	2,725	111	116	120	347
Transport	1,825	78	82	85	246
Communities	1,320	56	58	61	176
Justice	1,132	46	48	50	144
Environment & Rural Affairs	915	39	40	42	121
Education & Young People	642	26	27	28	81
Tourism, Culture & Sport	311	12	13	13	39
Scottish Executive Administration	261	10	11	11	32
Scottish Parliament & Audit Scotland	107	4	4	5	13
Crown Office	101	4	4	4	13
Food Standards Agency	11	0	0	0	1
<b>TOTAL</b>	<b>26,773</b>	<b>1,081</b>	<b>1,125</b>	<b>1,171</b>	<b>3,378</b>

Source: Scottish Executive (2006a); IFS (2007); own estimates

Under this scenario health & community care would receive an extra £1,273 million in cash terms over the next review period which compares to an extra £2,200 million

in the 3 years to 2007-08. Under this scenario expenditure on the development of Scotland's transport system would be more limited compared to recent years. Transport spending is forecast to rise by only £246 million in the next 3 years compared to £890 million in the three years to 2007-08.

**Scenario II:**

**Health & Education receive above average real increases whilst the overall budget remains pegged to a 2% real increase pa.**

Under scenario II it is assumed Ministers will continue to bias spending in favour of health care and education (both primary and secondary as well as higher and further education). In the last spending round (SR2004) total education expenditure grew by 3.8% pa in real terms. In the case of health the average annual real growth in spending was almost 8% (see Table 5).

**Table 5: Annual real growth in health and education spending in SR2004 (%)**

	<b>Primary &amp; Secondary</b>	<b>Further &amp; Higher</b>	<b>Total Education</b>	<b>Health</b>
<b>SR2004</b>	2.7%	6.2%	3.8%	7.9%

*Source: Scottish Executive (2006a)*

Demand for health care services will remain strong as pharmaceutical developments and technological advances feed the level of expectation on what can and should be freely available on the NHS. Spending on education across all sectors will remain significant as a key element in securing Scotland's long-term economic future.

Given the critical importance of these two key spending areas, scenario II assumes health and education are not limited to the overall 2% real rate of increase assumed in scenario I. The IFS analysis<sup>vi</sup> and the Budget 2007 statement<sup>vii</sup>, point to an annual real increase in education spending of 2.5% pa in real terms in England and Wales. Scenario II therefore assumes education spending<sup>viii</sup> aimed at increasing the skills and knowledge base of the Scottish economy<sup>ix</sup> rises by 2.5% pa in real terms between 2007-08 and 2010-11, a lower rate than that experienced in SR2004 (ref Table 5). Moreover, with the overall cap of 2% pa, this bias towards education leaves a maximum of a 3.85% real pa increase for health spending if no other Scottish portfolio is to face a cash cut. This too represents a sharp slowdown in spending from an average of nearly 8% real pa in SR2004. Tables 6 and 6a detail how scenario II translates into forecast spending levels for each of the Scottish Executive's portfolios between 2008-09 and 2010-11.

The impact of favouring health and education spending means all remaining portfolios will have to manage with almost no real increase in budgets.

**Table 6: Scenario II - Forecast increase in DEL by portfolio, £ million (nominal prices)**

	<b>Baseline 07-08</b>	<b>08-09</b>	<b>09-10</b>	<b>10-11</b>	<b>Average real increase pa</b>
Health & Community Care	10,247	10,854	11,496	12,177	3.84%
Finance & Public Sector Reform	7,176	7,403	7,635	7,873	1.11%
Enterprise & Lifelong Learning	2,725	2,822	2,923	3,027	1.54%
Transport	1,825	1,863	1,902	1,939	0.05%
Communities	1,320	1,348	1,376	1,403	0.05%
Justice	1,132	1,156	1,180	1,203	0.05%
Environment & Rural Affairs	915	934	954	972	0.05%
Education & Young People	642	665	690	715	1.65%
Tourism, Culture & Sport	311	317	324	330	0.05%
Scottish Executive Administration	261	267	272	278	0.05%
Scottish Parliament & Audit Scotland	107	109	111	114	0.05%
Crown Office	101	103	105	107	0.05%
Food Standards Agency	11	11	11	11	0.05%
<b>TOTAL</b>	<b>26,773</b>	<b>27,854</b>	<b>28,979</b>	<b>30,150</b>	<b>2.00%</b>

Source: Scottish Executive (2006a); IFS2007c; own estimates

**Table 6a: Scenario II -Forecast increase in DEL by portfolio, £ million (nominal prices)**

	<b>Baseline 07-08</b>	<b>08-09</b>	<b>09-10</b>	<b>10-11</b>	<b>Incremental Total</b>
Health & Community Care	10,247	607	643	681	1,930
Finance & Public Sector Reform	7,176	227	232	238	697
Enterprise & Lifelong Learning	2,725	98	101	104	303
Transport	1,825	39	38	38	114
Communities	1,320	28	28	27	83
Justice	1,132	24	24	23	71
Environment & Rural Affairs	915	19	19	19	57
Education & Young People	642	24	25	26	74
Tourism, Culture & Sport	311	7	7	6	19
Scottish Executive Administration	261	6	5	5	16
Scottish Parliament & Audit Scotland	107	2	2	2	7
Crown Office	101	2	2	2	6
Food Standards Agency	11	0	0	0	1
<b>TOTAL</b>	<b>26,773</b>	<b>1,082</b>	<b>1,125</b>	<b>1,171</b>	<b>3,378</b>

Source: Scottish Executive (2006a); IFS (2007); own estimates

Under scenario II, health & community care is forecast to receive around £700 million more over its allocation in scenario I. All other portfolios receive a smaller allocation than they would under scenario I (see Table 7). As an illustrative example of the difficulties this will cause, both scenario allocations provide substantially less than the £500 million received in the three years to 2007-08 by the Communities portfolio. There will therefore be considerable difficulties facing the post election administration should it wish to maintain the promise of delivering the current housing standard set for all local authority and socially managed housing.

**Table 7: Summary of forecast DEL spending, 2008-2011 (£ million)**

	Baseline 2007-08	Scenario I 2010-11	Scenario II 2010-11	Incremental increase from baseline		
				Scenario I 2008- 2011	Scenario II 2008- 2011	SR2004*
<b>Total DEL</b>						
- Nominal prices	26,773	30,150	30,150	3,378	3,378	5,352
- 07-08 prices	26,773	28,411	28,411	1,639	1,639	3,670
<b>Allocations (nominal prices)</b>						
Health & Community Care	10,247	11,520	12,177	1,273	1,930	2,200
Finance & Public Sector Reform	7,176	8,068	7,873	891	697	921
Enterprise & Lifelong Learning	2,725	3,072	3,027	347	303	262
Transport	1,825	2,070	1,939	246	114	890
Communities	1,320	1,496	1,403	176	83	494
Justice	1,132	1,276	1,203	144	71	272
Environment & Rural Affairs	915	1,036	972	121	57	117
Education & Young People	642	723	715	81	74	215
Tourism, Culture & Sport	311	350	330	39	19	78
Scottish Executive Administration	261	294	278	32	16	11
Scottish Parliament & Audit	107					-11
Scotland		120	114	13	7	
Crown Office	101	113	107	13	6	12
Food Standards Agency	11	12	11	1	1	1
Capital modernisation fund	0	0	0	0	0	-50
Contingency reserve	0	0	0	0	0	-58
<b>Total DEL</b>	<b>26,773</b>	<b>30,150</b>	<b>30,150</b>	<b>3,378</b>	<b>3,378</b>	<b>5,352</b>

\* The SR2004 increment is the total increase in spending for each of the three years 2005-06, 2006-07 and 2007-08.

Source: Scottish Executive (2006a); IFS (2007); own estimates



## APPENDIX

### Calculation of Education Expenditure

The total departmental expenditure (DEL) allocated to education (primary, secondary, further and higher) is the aggregate of expenditure from three separate portfolios; Enterprise and Lifelong Learning (ELLD), Education and Young People (E&YP) and Finance and Public Sector Reform (F&PSR). Summing the education (DEL) component in each portfolio produces a total education DEL that is funded by the Scottish Executive. Whilst identifying education spending programmes DEL in the ELLD and E&YP portfolios is straight forward, the education DEL included in the F&PSR portfolio is not clearly identifiable and requires adjustment because of the following factors:

- The Scottish Executive provides details on both grant-aided expenditure (GAE)<sup>x</sup> and aggregate external finance (AEF) allocated to local authorities. The former is the amount it estimates councils need to finance the provision of services (including education) whilst the latter is the total allocation actually provided by the Scottish Executive for all local authority services. The key difference between the GAE and AEF is the assumed level of internal funding local authorities secure from council tax. Consequently, since AEF is not itemised by type of service (ie, there is no explicit AEF for education) it is necessary to derive the share of AEF which is notionally allocated to its provision.
- Total managed expenditure (TME) for F&PSR includes a substantial amount of annually managed expenditure (AME) which again cannot be readily allocated to specific expenditure items. To derive the F&PSR's DEL for education necessitates the elimination of this AME amount.<sup>xi</sup>

The estimated DEL for education within the F&PSR portfolio is as follows:

$$\frac{F\&PSR\ education\ DEL}{DEL} = Total\ AEF \times \frac{Education\ GAE}{Total\ GAE} \times \frac{F\&PSR\ DEL}{F\&PSR\ (TME - SSPA)}$$

The methodology aims to obtain an estimate of the amount of F&PSR DEL that can be attributed to expenditure on education, ie the education DEL supported by the Scottish Executive. This is derived by multiplying the total AEF by the share of GAE accounted for by education which produces an estimate of the total education spending (ie, TME or AME plus DEL) supported directly by the Scottish Executive. TME is not split by its DEL and AME components at the sub-aggregate levels of expenditure but, roughly 20% of TME in 2007/08 funds the Scottish Public Pensions Agency (SPPA), which is classified as AME. So to derive the education DEL, we adjust our earlier estimate by the ratio of F&PSR DEL to F&PSR TME less the payment to SSPA.

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## NOTES:

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<sup>i</sup> The IFS derived rates of 2%, 1.9% and 2.7% real growth are their estimates for the rates to be applied to the Whitehall departments which have not yet had their spending settlements announced (Ref: IFS, 2007).

<sup>ii</sup> The main reasons for the sharp increase in capital spending 2005-06 are due to partly to a reclassification of “capital grants to the private sector” from resource spending to capital spending. It also reflects the impact of the sharp increase in the transport budget arising from the transfer of rail powers to Holyrood from Whitehall.

<sup>iii</sup> SR2002 is the spending review period covering years 2003-04 to 2005-06. SR2004 covers the years 2005-06 to 2007-08 and the comprehensive spending review (CSR) 2007 covers the years 2007-08 to 2010-11.

<sup>iv</sup> The Scottish Executive does not need to adhere to the growth rates applied in Whitehall. However, it has indicated it will allow flexibility around switching funds from resource to capital but not the other way round (see Scottish Executive, Draft Budget 2007-08, p 2). In 2004-05, 2005-06 and 2007-08 it implemented a 6.5%, 10% and 3.9% real increase in capital spending (see Scottish Executive, Building a Better Scotland, Infrastructure Investment Plan: p7, February 2005).

<sup>v</sup> In addition to the Scottish Executive’s distributed revenues, Scottish local authorities receive substantial incomes from council taxes and non-domestic rates. For the purposes of this analysis it is assumed that local authorities maintain the council tax rates and the Scottish Executive continues its non-domestic rates support at current levels.

<sup>vi</sup> IFS (2007)

<sup>vii</sup> HM Treasury (2007)

<sup>viii</sup> Education spending is split between 3 portfolios namely Enterprise and Lifelong Learning, Finance and Public Service Reform and Education and Young People. The methodology applied to derive the education DEL is given in the Appendix.

<sup>ix</sup> This therefore excludes the provision for teachers’ pensions and the funding of student loans as these are classified as AME spend. The student’s awards agency is also omitted from education spending leaving it to grow at the same rate as all other Scottish Executive spending portfolios.

<sup>x</sup> The Scottish Executive, (2006b)

<sup>xi</sup> There is some residual AME in ELLD that cannot be explained from the available data (c. 2% in 2007/08) so the ELLD education component has been adjusted by a factor 0.99.