Press Release 20th June 2008

CPPR 2010 project

ANALYSIS OF GOVERNMENT EXPENDITURE AND REVENUES IN SCOTLAND (GERS) 2006-07 PUBLICATION

MAIN FINDINGS

FISCAL BALANCE WITHOUT NORTH SEA REVENUES

- The Scottish fiscal balance for 2006-07, excluding revenues from the North Sea region, is estimated to be -£10.2bn
- This non-oil fiscal balance shows a trend growth over the 5 year period calculated, from -£8bn in 2002-03 to -£10.2bn in 2006-07

FISCAL BALANCE WITH NORTH SEA REVENUES

- When revenues from the North Sea sector are included this deficit is reduced. However, the extent of reduction depends on the share of the North Sea that is considered to be appropriate for Scotland. At a geographical related share of around 83%, the deficit falls to -£2.7bn in 2006-07
- The fiscal balance including North Sea revenues does not show a consistent pattern over time due to the erratic nature of these revenues

CURRENT AND CAPITAL SPEND WITHIN THE TOTAL FISCAL BALANCE

- For the first time GERS shows the fiscal balance split between current and capital expenditure. This makes it consistent with the presentation of such balances used in the UK Treasury's Budget Report
- This is a positive step presentationally. However, our analysis will continue to concentrate on the total fiscal balance which includes both current plus capital expenditures and which is more in line with the headline figures used by most governments and international bodies like the EU

CHANGES TO GERS FOR 2004-05

- The main revisions to the 2004-05 data presented in the 2006-07 publication are that (i) the data allocation has been refined so that, for example, more expenditure is now 'allocated' by country throughout the UK and as a consequence there is less 'unallocated' expenditure to be estimated between countries, (ii) the methodology has changed, principally on the revenue side
- These differences mean that the new estimate for the 2004-05 (the latest year covered by both this and the last editions of GERS) fiscal balance, excluding North Sea revenues, is -£9.1bn as opposed to the old estimate of -£11.2bn (ie, a reduction of £2.1bn, in the size of the deficit). This difference is roughly made of reductions of £700mn to

both expenditure on services and the Accounting Adjustment as well as an increase of £800mn to revenues

WIDER IMPORTANCE OF GERS

- The balance including the North Sea sector for years beyond 2006-07 is unclear due to uncertainty over future oil and gas prices and production
- The data should be viewed as a starting point in the discussion on Scotland's fiscal options in relation to the Calman Review and the proposed 2010 referendum. There exist a variety of ways of (i) reducing the non-oil fiscal deficit and (ii) using the North Sea revenues, which mean that the future picture of a Scottish fiscal balance could look very different to that shown in GERS

Background

CPPR'S APPROACH

The purpose of this analysis is to allow the reader to be able to judge:

- the trend movements from 2002-03 to 2006-07 in Scotland's fiscal balance, both including and excluding a proxy for North Sea related revenues

and

- the degree to which changes made in this GERS vs the previous 2004-5 GERS were due to (i) changes in the underlying UK data that would have occurred regardless of any methodological review of GERS, and (ii) changes due to methodological changes carried out as a result of this recent review.

TOWARDS 2010 - THE BIGGER PICTURE

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 therefore useful in telling us about the fiscal balance (i) under present conditions and (ii) excluding North Sea revenues. This non-oil balance is around -£10bn and is liable to slowly grow in cash terms (though not necessarily in real terms or as a % of GDP), purely as a result of inflation.

GERS is less useful in predicting forward to 2010 or beyond, what the 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 $135 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.

Current information on North Sea revenues suggests that the Fiscal Balance, including oil, will decline (i.e. the deficit will become bigger) in 2007-08 over 2006-07, as total North Sea Revenues fell from £9.1bn to £7.7bn. Thereafter the balance is likely to increase (i.e. the deficit will become smaller or even turn into a surplus), as the HM Treasury projection for North Sea revenues for 2008-09 is £9.9bn and even then this projection was based on a price much lower than that currently seen. However, as we are less than one quarter into the financial year 2008-09 there remains much uncertainty over what the final outcome will be.

Report authors comments

John McLaren, co-author of the report, said "***What this report makes clear is that under the current UK expenditure and revenue policies Scotland has a relatively large fiscal deficit excluding its share of the North Sea sector. However, the position can alter dramatically once uncertain North Sea revenues are included, depending on their size***."

Co-author Jo Armstrong highlighted that "***The changes seen in the latest edition of GERS are driven by both data changes and the Scottish Government's review of GERS' underlying methodology. These have resulted in a reduction of the non-oil deficit in earlier years worth over £2bn in 2004-05."***

Director of CPPR Richard Harris commented that **"*In terms of the 2010 debate there are essentially two different arguments that need to be considered. The first is what level of non-oil fiscal balance would best suit an independent, or fully fiscally autonomous, Scotland and how would this be best achieved. The second is how to treat oil revenues in terms of both helping fill the existing non-oil deficit and in terms of starting up and contributing to an Oil Fund which would provide government funds in the future*."**

CPPR's full report will be available on the CPPR website next week, following a full analysis of the data.

Contacts:

John McLaren – 07851 426498
Richard Harris – 07969 697224
Jo Armstrong – 07740 440766
John Moffat – (contact via CPPR)

http://www.cppr.ac.uk