

2011-12 – A DIFFICULT YEAR FOR SCOTLAND

Key message

The anticipated cut to the Scottish Government’s discretionary budget – ie, DEL - next financial year (2011-12) could readily lie in the range of £1.1bn to £1.5bn (in cash terms), equivalent to a fall over this year of between 5.2% to 6.2% in real terms and far higher than the “expected” 3% real terms cut. This difference is not simply due to the UK Government’s actions; rather it can be explained by 3 independent elements:

- **a loss of spending power from the £303mn of End Year Flexibility (EYF) for 2010-11 that will not be available in 2011-12**
- **£374m of delayed cuts from this week’s UK announcement for 2010-11 and,**
- **between £885m and £1,180m of expected real terms cuts from the upcoming Spending Review (SR) due in the autumn.**

Introduction

This update of a previous CPPR analysis (see CPPR, 2009) takes into account figures stemming from the £6bn cut in public spending introduced by the UK coalition government earlier this week. It examines these cuts in the context of other known and expected reductions to the Scottish Budget.

Table 1 below highlights the change in the Scottish Government’s likely discretionary spend, largely determined by its DEL (Departmental Expenditure Limit), moving from this year (2010-11) to next (2011-12).

Why the cuts are likely to be so deep next year

Discussion of the upcoming cuts to UK and Scottish Budgets are, in the main, based on the projected cuts for the next 3 years of around 3.2% per annum in real terms (i.e. adjusted for inflation), see the IFS’s ‘Green Budget 2010’ and Scottish Government’s ‘Outlook for Scottish Government Expenditure’.

However, these estimates do not take into account three important but additional factors that will affect the move from 2010-11 to 2011-12.

Table 1: Spending by Scottish Government 2009-10 to 2010-11, £million (CASH)

	2009-10 Actual	2010-11 Est	2011-12 CPPR Projection (HIGH)	2011-12 CPPR projection (LOW)
1 Total Scottish DEL ¹ @ March 2010	29,535	29,811	29,550	29,550
PLUS impact of UK Govt. May 2010-11 changes		42	-374	-374
2 Total Scottish DEL @ May 2010	29,535	29,853	29,176	29,176
3 End-Year-Flexibility (EYF) drawn down		303	-	-
4 Total Scottish DEL excluding EYF ie, Barnett baseline for 2010 Spending Review ²		29,550	29,176	29,176
Expected % change to baseline from SR (IFS basis) real			-3%	-4%
Expected % change to baseline from SR (IFS basis) cash			-1.5%	-2.5%
5 Expected cash change to baseline from SR, £m			-443	-739
6 Total DEL Projection ³ , £m			28,733	28,437
TOTAL projected change in DEL from 2010-11 (%)			-3.8%	-4.8%
TOTAL projected change in DEL from 2010-11 (£m) ⁴			-1,120	-1,416
<u>Excluding inflation⁵</u>				
Total DEL, £m (2010-11 prices)			28,308	28,016
Projected change in DEL (%)			-5.2%	-6.2%
Projected change in DEL (£m)			-1,545	-1837

¹ The cash DEL figures for 2009-10 and 2010-11 both include £100 million of budget over allocation made by the Scottish Government. This practice has been continued for 2011-12 to make the totals comparable across all years.

² There is some uncertainty over what the baseline will be due to this week's changes but the level of uncertainty should result in little impact on the final figures shown here.

³ Equals 2010-11 figure in row 2 less EYF in row 3 and cuts shown in row 5.

⁴ Equals 2011-12 figure(s) in row 6 less 2010-11 figure in row 2.

⁵ Adjusted using GDP deflator given in Budget 2010, Table C1.

Sources: Scottish Parliament; HMT; IFS; CPPR projections

First, neither the IFS nor the Scottish Government factor in the impact of EYF on the budget in this transition year. The recent draw-downs of EYF have all but exhausted this source of boosting annual expenditure and its loss will exaggerate the decline between these two years. While it is possible that further EYF relating to 2009-10 and/or to 2010-11 may be available in 2011-12 it seems unlikely that this will be on a par with the scale of recent draw-downs[†], partly as these had accumulated over a number of years and partly as tighter budgets are more likely to lead to lower underspends. Indeed, it is not even certain that EYF rules will remain as they are, as

[†] Since 2007-08 total EYF drawn or projected to be drawn to fund the Scottish Government's budget amounts to around £1 billion (see Scottish Government 2007 and Scotland Office 2010).

stricter conditions on using these unspent sums may apply in the new world of public finances that now exist.

Second, this week's 2010-11 related cuts have been delayed in Scotland, now to be applied in 2011-12. This would not have changed the underlying position for 2011-12 from before if it simply meant a bringing forward of cuts to this year from next, but within the same overall size of cut. However, it seems likely that this accelerated cut is also an additional cut. That is because the UK coalition government has committed itself to "*significantly accelerate the reduction of the structural deficit over the course of a Parliament*". We will not know for sure about this until the June Budget, based on the Office for Budget Responsibilities initial borrowing forecasts. However, all the body language so far is that this extra urgency is needed due to internal worries with regards to overoptimistic forecasts (of both growth and of borrowing) and external worries with regards to the worsening mood of financial markets over government debt concerns.

Third, the IFS in their Green Budget of 2010 estimated that the average reduction of 3.2% a year for the 3 years to 2013-14, if adjusted for the year-by-year changes known for other budgets items (ie, mainly Annually Managed Expenditure - AME), was likely to be -4% in 2011-12, -2% in 2012-13 and -3.6% in 2013-14.

Each of the three effects described above impacts negatively on the likely cut to the Scottish Budget in 2011-12. As a result, it moves from an initial real terms reduction, without including any special factors, of -3.2% to one of up to -6.2%, almost double the unadjusted figure.

To put this in a historical context, instead of the Scottish Government's budget increasing by 5%-6% in real terms, as it did on average during the first decade of devolution, in 2011-12 we are now looking at a fall of a similar size.

Frontloading the pain

Eventually the UK, and by implication Scotland, will be seeking to get to the same position of a more balanced budget that is sustainable. To that extent this cut simply frontloads the pain of getting to this position.

However, the downside of this profiling of cuts is that budget holders will have very little time to put in place arrangements to take account of these historically large negative adjustments. This makes the findings of the Independent Budget Review Group in Scotland especially important. It needs to highlight cuts that can be achieved quickly whilst also reinforcing a sense of urgency in planning for these and additional future cuts. In turn, the Scottish Government needs to start to outline where it envisages making upcoming cuts across services over the summer, rather than waiting until after the UK Spending Review in the autumn. As we are already aware of the general scale and timing with regards to these cuts there is no excuse to delay clarifying major changes in funding for those bodies that will need to put them into practice.

While 2011-12 will be the worst year for cuts, they will continue, in cash terms and for even longer in real terms, for a number of years to come. The more managed is this cumulative decline the less affect it will hopefully have on the quality of public services available to the Scottish public. Year one should act as a template for future cuts; if it does not clearly lay out the rationale for the decline in years ahead, across different services, then there is a danger that the public and budget holders will become confused and less acceptant of, and co-operative in, implementing change.

Conclusions

As has been highlighted for some time, the prospects for Scotland's Budget remain grim. Next year poses a very strong challenge in managing the downturn given it will mean a severe reversal in approach for many. The earlier that important decisions are made the better, no matter how unwelcome the outcomes are likely to prove.

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