

SCOTLAND OFFICE BACKGROUND PAPER

THE SCOTTISH BUDGET SINCE DEVOLUTION

This Paper presents the Budget assigned to the Scottish Government, since the commencement of Devolution.

DECEMBER 2009

INTRODUCTION

The budget available to the Scottish Government has been the subject of debate in recent months and looking forward, there is much speculation about the possible future level of public expenditure in Scotland. As the Secretary of State for Scotland fulfils a statutory role in transferring funds from the UK Government to the Scottish Budget, The Scotland Office is uniquely placed to provide a detailed confirmation and analysis of the budget available to the Scottish Parliament since devolution in 1999 to the present day.

The main findings are:

- Next year, the Scottish budget will be at its highest ever level, in both nominal terms and real terms, since the start of devolution;
- Since the start of devolution, the Scottish budget has increased year on year. In real terms, the Scottish Budget for 2010-11 is 60% higher than that available to Donald Dewar in 1999-2000 and 104%, or more than double, in cash terms. This in turn has provided for increasing levels of expenditure on public services during this period.
- Long term analysis of the estimates of Scotland's fiscal balance show that Scotland has a structural fiscal deficit, indicating that the present total level of public expenditure in Scotland could not be sustained if it were to be funded solely from Scottish tax receipts.
- As well as rising substantively through time, the Scottish budget has also been protected from revenue shocks during this period. Maintaining constant levels of public service provision would have been significantly more complex if the Scottish budget had been entirely derived from Scottish tax receipts over this period. This is especially true for annual tax receipts from oil and gas production which, since devolution, have varied by amounts equivalent to one third of the present Scottish budget.
- Amidst a global recession, the Scottish budget will be higher than ever before in 2010-11, reflecting a real terms rise of 1.3% over the 2009-10 budget, and a real terms increase of 3.5% over the year to 2009-10. This can be contrasted to Ireland, where an anticipated 32% fall in government tax revenues over 2007 to 2009 is requiring immediate dramatic cuts in government expenditure.

COMPONENTS OF THE SCOTTISH BUDGET

The Scottish budget is integrated within the wider UK public expenditure system. The entire budget available to Scottish Ministers and the Executive (now more commonly known as the Scottish Government) is termed **Total Managed Expenditure or TME**.

TME is the aggregate of public spending and is the sum of the Departmental Expenditure Limits (DEL) and Annually Managed Expenditure (AME). Within the Scottish Administration, the Scottish Government proposes spending plans, but the ultimate budget bill needs to be approved by the Scottish Parliament.

Departmental Expenditure Limit (DEL)

The largest (around 80%, presently approximately £30 billion) component of the Scottish Government's TME is the Departmental Expenditure Limit, or DEL. Although the remaining component of the Scottish TME – Annual Managed Expenditure – is allocated within the same Scottish budgetary process, the Scottish DEL in practice defines the total budget available to the Scottish Government and Parliament to finance discretionary public expenditure in fulfilment of its chosen policies. It is financed entirely by the UK Government, reflecting that taxes in Scotland and everywhere else in the UK are collected centrally.

Since 1997, DEL for all parts of government, including the devolved administrations in Scotland, Wales and Northern Ireland, are determined for 3 year periods in biennial spending reviews. The Scottish DEL is determined by increments, calculated by the Barnett formula being added (or subtracted) from the baseline year of the spending review period. The Scottish DEL is sometimes referred to as the block grant to the Scottish Parliament. Any changes calculated by the Barnett formula ensure that all parts of the UK receive the same per head changes in public expenditure. As these incremental changes apply to the existing budget, the budget available to the Scottish Parliament benefits from a high degree of stability from one year to the next.

The Scottish DEL covers most programme expenditure, the largest amounts relating to health, local government and education, but in particular, DEL covers those expenditures that can reasonably be subject to close control over a three year horizon. In practice, Scottish DEL is the component of the Scottish budget which enables the Scottish Government to deliver their chosen policies.

Annually Managed Expenditure (AME)

AME is the part of TME which does not fall under DEL, representing around 20% of the Scottish budget, or approximately £5 billion at present. Expenditure defined as AME relates to programmes that are generally less predictable and controllable than DEL and cannot reasonably be subject to firm multi-year limits like DEL. AME budgets are therefore subject to review twice a year, to allow the most up to date information to be incorporated in the financial management and budgeting process.

At the UK level, the principal expenditures under AME include social security benefits and tax credits, but within Scotland these are reserved to the UK Government, so are not part of the Scottish Budget. The largest expenditures from the Scottish AME budget are NHS and teachers pensions, whilst income from Non Domestic Rates (NDR) collected by Local Authorities is recorded as AME. This will also not be readily determined over a 3 year spending review, reflecting real world factors around the tax base to which NDR apply, and the fact that the stock of properties on which NDR income is paid is not fixed through time. The remainder of the AME budget is met directly by the UK Government.

An analysis focussing on the Scottish DEL rather than TME therefore understates the Scottish budget but more accurately depicts the budget available to the Scottish Government to meet its policy objectives. Although AME comprises part of the Scottish budget and is directly managed by the Scottish Government, variations in AME do not in themselves impact upon the Scottish Government's budget available for it to meet its spending priorities. Furthermore, AME expenditure is met directly by the UK Government and is not part of either the starting baseline or the Barnett process for determining the Scottish budget. For these reasons, the major part of this paper focuses on the Scottish DEL.

THE SCOTTISH BUDGET SINCE DEVOLUTION

The Scottish Departmental Expenditure Limit in Nominal & Real Terms

The data presented in table 1 and chart 1 below show that since the commencement of devolution, the Scottish budget has more than doubled in nominal terms, and risen by 60% in real terms.

Year	Nominal DEL (£ m) (net of depreciation)	Real Terms DEL (£ m) At 2009-10 prices
1999/2000	14,273	17,941
2000/2001	15,296	18,978
2001/2002	16,720	20,291
2002/2003	18,098	21,277
2003/2004	20,409	23,336
2004/2005	21,430	23,841
2005/2006	22,880	24,988
2006/2007	24,920	26,434
2007/2008	26,333	27,178
2008/2009	27,153	27,425
2009/2010	28,375	28,375
2010/2011	29,169	28,738

Table 1: Scottish Budget since Devolution

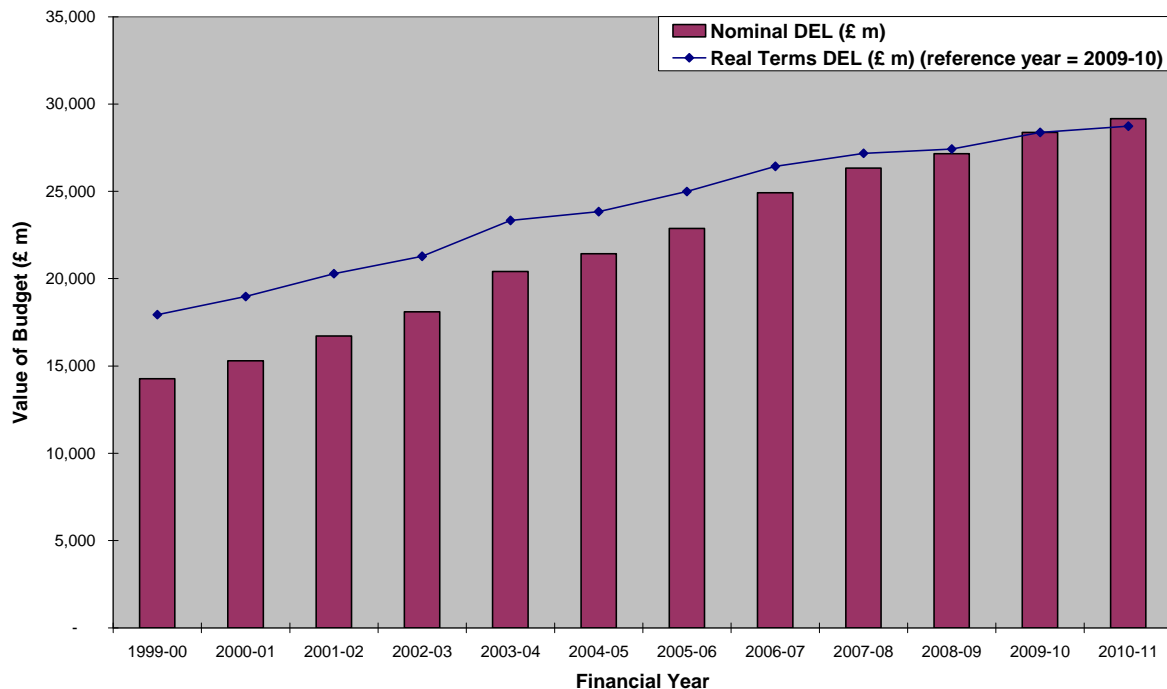


Chart 1: Scottish Budget since Devolution

Reconciliation between Scottish Allocated Budget and the Scottish Budget net of End Year Flexibility and Capital Re-profiling

Table 1 and chart 1 focus on the Scottish DEL budget *allocated* by the UK Government for a particular year. They intentionally do not capture the effects of the Scottish Government or Executive deferring expenditure from one year to another under the End Year Flexibility (EYF) arrangements allowed in the UK public expenditure system. The recent capital re-profiling, when the Scottish Government accessed the allocated capital budget for subsequent years, is similarly not shown.

Other published sources of this data (specifically the annexes in the *Scotland Office Annual Report* and *HM Treasury's Public Expenditure Statistical Analyses (PESA)*¹) reflect the actual budget spent by the Scottish Parliament, and therefore present any accumulation and drawdown of EYF and capital re-profiling on a cash basis, rather than on an accruals basis. Neither of these change the totality of the Scottish budget over time as they simply move expenditure from one year to another, but they do change the budget in one particular year.

Table 2 below therefore reconciles the Scottish budget reported in these sources with the allocated budgets set out in table 1. Table 2 shows that the differences between PESA and the Scotland Office Annual Report data derive from the treatment of depreciation, whilst differences between the PESA publication and the allocated budget is entirely attributable to the shifting of monies from one year to another.

£ million	Scottish DEL as per Scotland Office Annual Report Annex	Less Depreciation	Equals Scottish DEL as per PESA	Add/subtract Net Under spend (underspend minus EYF drawdown)	Add/subtract Capital Re-profiling	Equals Scottish Allocated DEL as in Table 1 above
1999/00	14,260	113	14,147	126		14,273
2000/01	15,131	108	15,023	273		15,296
2001/02	16,910	170	16,740	-20		16,720
2002/03	18,152	223	17,929	169		18,098
2003/04	20,118	203	19,915	494		20,409
2004/05	21,630	417	21,212	218		21,430
2005/06	23,181	330	22,851	29		22,880
2006/07	25,389	438	24,951	-31		24,920
2007/08	27,368	422	26,946	-613		26,333
2008/09	27,935	459	27,476	-270	53	27,153
2009/10 ²	29,133	465	28,669	-	294	28,375
2010/11	29,310	489	28,821	-	-348	29,169

Table 2: Reconciliation between Scottish budget reported in the Scotland Office Annual Report, HM Treasury PESA and the Scottish allocated budget. (Totals may not sum due to rounding)

¹ Earlier versions of each publication will report budgets that may subsequently have changed during a Spending Review period, as any Barnett derived changes to UK public expenditure announced at the annual Budget and Pre-Budget Report stages are incorporated. These differences are reconciled in annex 2 of the Scotland Office Annual Report.

² The 2009 Winter Supplementary Estimate updated the Scottish Budget for 2009-10 and added £419million to the 2009-10 Scottish Budget. Budgets for other years are unchanged.

Relationship between the Scottish Budget and Tax Receipts

Within the UK Public Expenditure System, taxes, and indeed many expenditures, are not ascribed on a geographical basis. Hence, the allocated Scottish budget, and indeed the entire Scottish Total Managed Expenditure, does not directly relate to Scottish tax receipts, aside from Non Domestic Rates income and the effect of the unused tax varying power (the Scottish Variable Rate of +/- 3p).

Whilst the increasing prosperity of the UK as a whole is reflected in the long term increase in the Scottish assigned budget, the year on year stability is attributable to it not being directly linked to Scottish tax receipts. All tax receipts are inherently prone to a degree of volatility, though some more than others. The degree of protection conferred on the Scottish budget by this practice is none more acute than in the case of tax receipts from oil and gas exploitation in the UK Continental Shelf. As with all other tax revenues other than local taxes, oil and gas tax receipts are collected on a UK wide basis and then redistributed.

The Independent Expert Group advising the Commission on Scottish Devolution noted that substituting a proportion of the existing Barnett derived Scottish budget with oil and gas revenues would “expose the Scottish Parliament to significant revenue variations”. This volatility can be seen in chart 2 below, which compares the Scottish budget and the total (ie not just attributable to activities in what might be termed Scottish waters) of UK oil and gas taxation receipts. Between 1999-2000 and 2010-11, actual or predicted oil and gas revenues for all UK oil and gas production varied between £3.2bn in 1999-00, and £13.1bn in 2008-09. That is to say, the fluctuations in oil and gas taxation receipts alone correspond to around one third of the total budget of the Scottish Parliament.

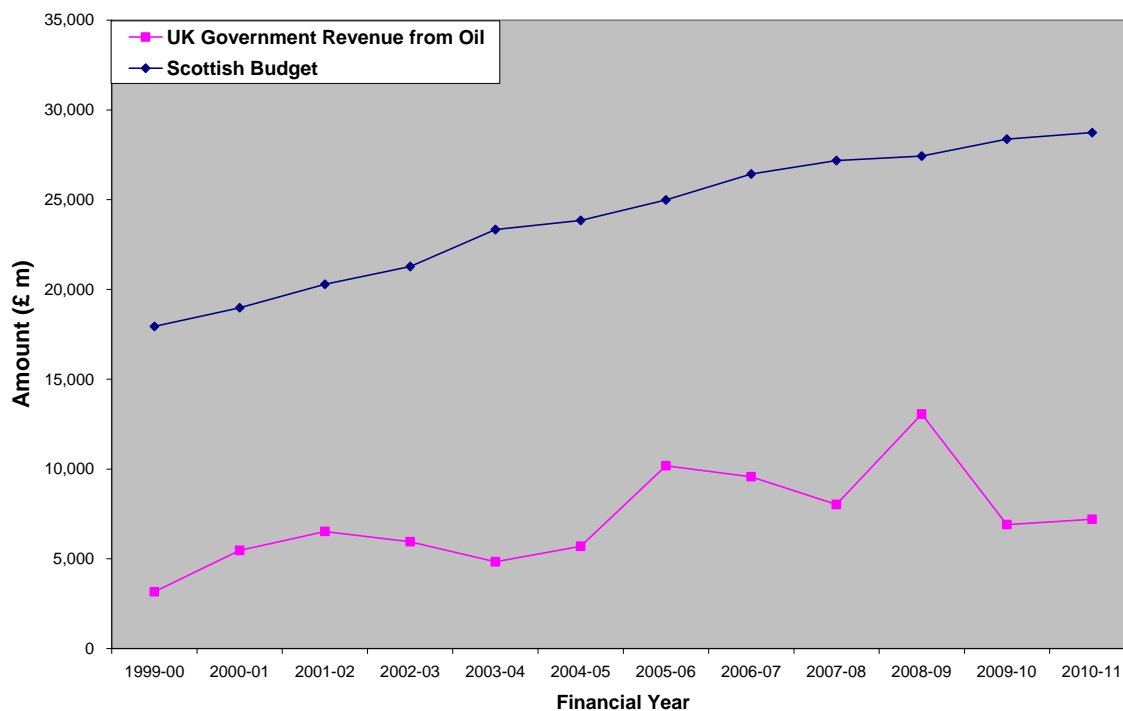


Chart 2: The Scottish Budget and all UK oil and gas taxation receipts

In contrast, the Scottish budget has been steadily increasing in real terms, year on year. This stability in revenues also reflects the predictability of the associated expenditure - public service provision largely relates to the payment of wages within the public sector, for example on teaching professionals, medical staff and policing. It is interesting to contrast this position with that of Ireland where an anticipated 32% fall in government tax revenues over 2007 to 2009 is requiring immediate dramatic cuts in government expenditure.

Relationship between the Scottish Budget and Total Public Expenditure in Scotland.

The Scottish Government's *Government Expenditure and Revenue in Scotland* (GERS) series estimates taxes paid in Scotland and compares these to the totality of Government expenditure in Scotland. As well as the Scottish budget, this also includes identifiable expenditure by the UK Government in Scotland (for example on DWP and HMRC social protection spending) and non-identifiable expenditure by the UK Government on behalf of Scotland (for example for defence and overseas representation).

The most recent GERS data relates to 2007-08. This shows that the total expenditure by the Scottish Government was £32,322 million, identifiable expenditure by the UK Government in Scotland was £13,652 million and non-identifiable expenditure by the UK Government in or on behalf of Scotland was £6,903 billion. In other words, expenditure by the Scottish Parliament accounts to around 60% of the totality of Government Expenditure in or on behalf of Scotland.

Over time, public expenditure exceeds estimated tax receipts in Scotland. The Scotland Office Background Paper *Scotland and Oil* published in July 2009 explored the relationship between expenditure and tax receipts in Scotland over time. It showed that if all North Sea oil revenues, in addition to the existing block grant, had been allocated to Scotland, there would only have been 9 years out of the last 27 when Scotland's finances would have been in surplus. The same paper estimated that this equated to a total deficit outweighing the total surplus by £20bn since 1980-81.

FOCUS ON THE CURRENT COMPREHENSIVE SPENDING REVIEW PERIOD 2008/09 – 2010/11

In contrast to the previous analysis which has focussed on the allocated Departmental Expenditure Limit (DEL), this section considers the entire Scottish budget for the current spending review period of 2008-09, 2009-10 and 2010-11. They are presented to provide a definitive portrayal of the Scottish budget for this period and reflect changes that have applied to the original allocations arising from the 2007 Comprehensive Spending Review (CSR).

These figures take into account - as above - depreciation, net underspend, and the decision of the Scottish Government to accelerate some capital expenditure, within the three year spending period, in the same way as the UK Government (this did not represent any change to the amount of funding available to the Scottish Government within this three year spending period). As with the data elsewhere in this paper, they are consistent with the annexes of the Scotland Office Annual Report. However, the AME figures set out in table 3, and consequently the Total Managed Expenditure (TME) figures, are different to those cited in the Scotland Office Annual Report, reflecting that AME budgets are revised twice each year, reflecting that they are inherently less predictable and controllable than spending treated as DEL.

The same also reflects Non Domestic Rates (NDR) income, which will vary over time. This reflects real world factors around the tax base to which NDR apply, and the fact that the stock of properties on which NDR income is paid is not fixed through time.

Table 3 identifies changes to the 2009-10 DEL budget emerging from the Winter Estimates published in November 2009- these resulted in a net increase in the expected 2009-10 budget, including the Scottish Government being able to draw down £400 million unspent from previous years accrued under the EYF arrangements. The budgets for other years are unchanged.

Also reflected in table 3 are the most recent estimates for NDR income and AME budgets. For comparison, the figures that were the basis for Secretary of State's prior projection of the Scottish Budget yield a TME of £34.8 billion for 2009-10 and £35.5 billion for 2010-11. These yielded a real terms TME increase of £1.2 billion for 2009-10 (or 3.5%, in real terms) and a real terms TME increase of £0.2 billion for 2010-11 (or 0.5%, in real terms).

On the basis of the most up-to-date information available, and as set out in table 3 below, the total Scottish budget will increase in real terms by £1.1 billion in 2009-10 (equivalent to 3.5%) and £648 million in 2010-11 (equivalent to 1.9%) – a marginally larger increase than previous projections.

£ m	2008-09 (£ m)	2009-10 (£ m)	2010-11 (£ m)
Assigned DEL (net of depreciation)	27,153	28,375	29,169
<i>Capital re-profiling</i>	53	294	-348
<i>Depreciation</i>	459	465	489
<i>Net underspend</i>	-270		
<i>DEL (as per Scotland Office Annual Report 2009)</i>	27,935	29,134	29,310
AME	3,338	3,462	3,676
Non Domestic Rates (NDR) Income	1,860	1,971	2,127
Total Managed Expenditure (TME) (= Assigned DEL + AME +NDR)	32,351	33,808	34,973
<i>Capital re-profiling</i>	53	294	-348
<i>Depreciation</i>	459	465	489
<i>Net underspend</i>	-270		
<i>TME (including Depreciation, capital re-profiling and net underspend)</i>	33,133	34,567	35,114
GDP Deflator	99.01	100.00	101.50
Assigned DEL in real terms (2009-10 prices)	27,425	28,375	28,738
Real Term % DEL changes		3.5%	1.3%
TME in real terms (2009-10 prices)	32,674	33,808	34,456
Real Term TME % changes		3.5%	1.9%

Notes: 1) Totals may not sum due to rounding; 2) This table does not include the 2009 winter supplementary estimate which added £419 million to the 2009-10 budget. Other years were unchanged.

Table 3: Scottish Budget over the current CSR period

CONCLUSIONS

- Next year, the Scottish budget will be at its highest ever level, in both nominal terms and real terms, since the start of devolution;
- Since the start of devolution, the Scottish budget has increased year on year. In real terms, the Scottish Budget for 2010-11 is 60% higher than that available to Donald Dewar in 1999-2000 and 104%, or more than double, in cash terms. This in turn has provided for increasing levels of expenditure on public services during this period.
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KEY REFERENCES

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Scotland Office *Annual Report 2009 and previous years*

Scotland Office *Scotland and Oil - Background Paper, June 2009*

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