CPPR
Centre for Public Policy for Regions

THE SCOTTISH GOVERNMENT'S BUDGET

GROWTH PROSPECTS AND BUDGET OPTIONS

Commissioned by
SOLACE
CIPFA Directors of Finance

Supported by
The Improvement Service

John McLaren
Jo Armstrong
August 2009

Contents

1. Key messages

- **There seems little doubt that real terms reductions in the Scottish Government's budget are coming and these reductions will take place over a number of years not just in the near-term or requiring short-term, one–off adjustments;**

- **At this stage, a 'best guess' of what this could mean is an 8.5% (£2.5bn) real terms cut in the Scottish Budget between 2009-10 and 2013-14;**

- **The risks attached to this estimate are mainly on the downside, i.e. the cuts could be greater, depending on how optimistic the Treasury's forecast are for GDP growth and interest rates;**

- **The timetable for deciding the future size of the Scottish Government's Budget could mean that budget holders will have only 4 months in which to allocate funds;**

- **If Health and/or Education in Scotland are protected from any cuts this would seriously worsen the size of the cuts in all other services**

- **With wages accounting for roughly half of the Scottish Budget, the extent to which they avoid being reduced seriously impacts on the size of cuts to non-wage budget items;**

- **In general, any concessions to one budget holder will automatically enforce deeper cuts on all other budget holders, or higher fees and charges, to compensate;**

- **If Health avoided any real terms cuts then the -8.5% figure could rise to -13% for the non-Health budget; if the total wage bill is not capped the cut elsewhere could rise to -17%; and if both the wage bill and Health avoided cuts it could rise to -25%; if Education were added to these two protected areas then the cut to non Health, non wage bill, non Education budgets could stand at -40%;**

- **Lessons on how more for less could be delivered may be learned from other parts of the UK in relation to Education and Water supply which might help ease the situation;**

- **Many strong challenges await budget holders in attempting to accommodate these cuts, including questions relating to prioritisation structural re-organisation, and the shift in focus from inputs to outputs;**

- **The anticipated downturn in budgetary prospects is set to be deep and prolonged. Wherever possible, preparations for these austere times are likely to improve the effectiveness of the final budgetary decisions made.**

2. Introduction

The purpose of this Report is to highlight the upcoming squeeze on the Scottish Government budget post 2009-10. While the exact size and length of this squeeze will depend on a number of factors, there seems little doubt that real terms reductions in the budget will occur in the coming years and that such reductions will occur over a number of years rather than as a short-term, one–off, adjustment.

We are not suggesting that the final Scottish Government budget will match our forecasts exactly. Rather, we are suggesting that the general trend of our spending profiles will come about and so it is these trends, rather than the detail, that should be focussed upon.

The two most important elements to this report are:

- the move from high real terms budget growth post devolution to negative real terms, and possibly even cash terms, growth; and,
- the prolonged nature of this downturn.

Both have major implications for public sector budgets within Scotland as well as for the psychology brought to bear on how to approach such budgets in the future.

This paper follows on from the Improvement Service paper - Public Expenditure Trends: A Note.

3. Scottish Government spending estimates

CPPR has previously produced 3 scenarios on the likely size of the Scottish Government's Budget (i.e. discretionary spending, also known as its Departmental Expenditure Limit, or DEL) over the next spending review period, i.e. to 2013-14[1]. However, in order to simplify discussion this Report concentrates on the middle scenario, which is in line with the latest Institute of Fiscal Studies (IFS) analysis of the UK position and which is often commented upon in the media. While it is important to remember that, in current circumstances, these numbers represent only one of a wide range of possible outcomes, this range extends from bad to worse. The chances of a standstill or positive growth outcome are vanishingly small (see also next section on risks).

Table 1 shows that the Scottish Budget is estimated to be higher this year (2009-10) compared to last, by 4.6% in real terms. Thereafter, the budget outlook is for a steady decline between 2009-10 and 2013-14, amounting to an 8.5% fall in real terms over the 4 year period (or virtually flat in cash terms). This is equivalent to a fall of £2.5bn in Scotland's £30 billion-odd Budget.

To put this into context, since devolution, the Scottish Government's budget has risen on average 5.5% per annum in real terms.

---

[1] See http://www.cppr.ac.uk/media/media_110548_en.pdf and http://www.cppr.ac.uk/media/media_117320_en.pdf for a fuller description of these scenarios.

Table 1: Spending by Scottish Government 2008-09 to 2017-18, £ billion

	08-09	09-10	10-11	11-12	12-13	13-14	17-18
Total Scottish Budget (DEL)							
- Cash	**28.1**	**29.7**	**29.6**	29.5	29.7	29.8	34.5
- Real	**28.1**	**29.4**	**28.9**	28.1	27.5	26.9	28.0
% change yr-on-yr (cash)		5.7%	-0.3%	-0.25%	0.5%	0.5%	3.75% pa
% change yr-on-yr (real)		4.6%	-1.7%	-2.7%	-2.3%	-2.3%	1.0% pa
% change vs 09-10 (real)			**-1.7%**	**-4.4%**	**-6.5%**	**-8.5%**	**-4.8%**
Change Vs **09-10** - £CASH			-0.1	-0.2	0	+0.1	+4.8
Change Vs **09-10** - £REAL			-0.5	-1.3	-1.9	-2.5	-1.4

Source: CPPR's own calculations. The real terms % change reductions, -2.3% post 2010-11, are based on IFS assumptions and projections.

The real terms % changes shown in Table 1 result from recent UK Treasury Budget announcements of changed funding levels and the acceleration of spending from next year to this, hence the large rise in 2009-10, followed by a drop in 2010-11. Thereafter, the real terms falls of between 2.3% and 2.7% a year are based on the IFS's projections, post Budget 2009. Given these assumptions, the overall real terms fall in the Scottish Budget between 2009-10 and 2013-14 is estimated to be 8.5%. Between 2009-10 and 2017-18 it is a real terms fall of almost 5%. (See Annex A for more details on the assumptions behind this scenario.)

4. Upside and Downside Risks

It is important to remember that, especially in the current economic and financial environment, these projections are uncertain. There are both upside and downside risks that apply in relation to, for example, how quickly and how strongly UK economic growth recovers.

At present most of these risks would appear to be on the downside, ie, the UK budget may turn out to be lower than forecast and the budget cuts could be even higher than outlined in Table 1. This is especially so in relation to the level of economic growth for the UK and to the level of debt interest payments.

Most outside forecasters consider the H.M. Treasury recovery profile to be optimistic. Whereas the Treasury's forecasts for GDP growth for the period 2009 to 2013 currently are -3.75/1.0/3.25/3.25/3.25%, those for independent forecasters are consistently lower at -4.0/0.6/1.9/2.4/2.6%. Cumulatively this would have a significant and negative impact on both expected GDP levels and so on government revenues.

The current low interest rate environment is helping to cap the size of the UK Government's total interest payments. However, as and when interest rates begin to rise or debt levels turnout to be higher than forecast, the resultant higher interest payments will simply feed through to less cash being available for departmental spending, given the assumption of an overall cap on total public spending.

Uncertainty also exists over how the UK government will address the issue of reducing its deficit. Irrespective of which party is in power, the UK Government will have to decide whether to increase taxes or reduce spending and, where spending cuts are required, how these are then allocated across the various UK spending departments. This latter point is very important for Scotland as budget reductions will only be passed on to Scotland if they are in areas of devolved spending e.g. health, education etc, but not if they occur in reserved areas e.g. defence. In purely budgetary terms, a good scenario for Scotland might be if, for example, Trident is scrapped as this would not follow through to the Scottish budget.

However, additional downside risks apply here as there may be scope to revisit or scrap the Barnett Formula and, in doing so, to apply harsh reductions to the Scottish budget, which is generally reported as having spending above its per head needs level (i.e. in 2007-08 Scottish spending related to Barnett relevant services was roughly 25% per head above the English average). The recent (July 2009) House of Lords report on the Barnett Formula was another push in this direction, although it also highlights the need for any such change to involve “a carefully handled transition”.

5. Timetable

It does not look like we will get much greater clarity on post 2010-11 budgetary decisions until after the next UK election as the Chancellor of the Exchequer recently (Financial Times, 12th June) stated that he had no plans for a spending review, as would be normal, this autumn.

This means that a possible timetable leading up to the setting of budgets post 2010-11 could look like the following:

- UK election, May 2010
- UK Spending Review announcement including devolved government Budgets, late August 2010
- Scottish Spending Review announcement, November 2010

This would leave only 4 months for budget recipients to put in place arrangements to accommodate these new budgets.

Even once the Block Grant for the Scottish Government is known, uncertainty will remain until the Scottish Government allocates its budget within the many services covered by the Scottish Parliament. In particular, there may remain great uncertainty over whether the capital budget in Scotland will be cut to the same extent as at the UK level, where H.M. Treasury’s Budget Report shows net investment being halved, in cash terms, between 2009-10 and 2013-14. Clearly this will impact on the non-capital, resource, settlement.

From the above warnings the clear message is that, while great uncertainty reigns, it is an uncertainty that is nevertheless bounded by the near certainty of real and prolonged reductions in the budgets available to all levels of government. Preparation for such reductions will enable better decision making when the time finally comes to accommodate declining budgets.

6. Impact of protecting Health and Education

There has been much discussion in recent weeks amongst political parties at Westminster over which, if any, parts of the UK government should be protected from any cuts. Three areas in particular have been mentioned – Health, Education and International Development. This section looks at the implications of protecting Health and Education (International Development can be ignored for now as it is both reserved and relatively small) both at the UK and the Scottish levels.

The main implication for Scotland of protecting Health and Education at the UK level is that it is likely to reduce the negative knock-on Barnett Formula related effects on the Scottish Budget. The more devolved-areas like Health and Education are protected the more likely it is that cuts will have to be found in reserved budgets which are not subject to Barnett. As both the Health and Education budgets are so big this means that very large cuts will then need to be found in areas like Defence.

However, there are two 'risks' associated with this possible scenario. The first is that for Whitehall to avoid any devolved settlement that is relatively beneficial, the Barnett Formula funding mechanism is suspended for the next Spending Review and an adhoc one is introduced. This could be something as simple as Scotland, Wales and Northern Ireland receiving the same percentage cut, or per head cut, overall as occurs for the UK total (DEL) budget.

The other 'risk' is that the Scottish Government follows the example of the UK government and protects Health and Education. The Calman Commission's first report of December 2008 highlighted the size and growth of spending on Health and Education in the Scottish Budget (see Table 2).

Table 2: Size and growth of spending on Health and Education in Scotland (cash terms)

	Education & Training			**Health**			**Total DEL**	
	£ billion	**% change**	**% total DEL**	**£ billion**	**% change**	**% total DEL**	**£ billion**	**% change**
1999-00	4.4		31%	6.5		46%	14.1	
2007-08	7.5	70%	27%	9.9	52%	36%	27.4	94%

Source: Calman first report

Both these service areas have benefited from huge budget increases post devolution, between them receiving roughly half the overall increase in total DEL and accounting for almost two-thirds of the Scottish Government's total spending. As a result, if the Scottish Budget were to be cut by 8.5% in real terms between 2009-10 and 2013-14 (i.e. consistent with Table 1 figures), but Health spending was excluded from these cuts, the reduction required from the remaining non-Health budgets would rise to around 13%. If Education and Training were also omitted then the remaining, non-Health non-Education budget would suffer cuts of over 25%. (Note Annex B shows how the Scottish Budget is currently spent across portfolios.)

The importance of **not** protecting Health and Education has been highlighted by two recent (July 2009) reports. The first, the "Report of the Special Group on Public

Service Numbers and Expenditure Programs" for the Irish Finance Minister, looked across all Departmental Budgets and recommended cuts in both expenditure (of over €5 billion) and staff numbers (of over 17,000). The largest staff cuts were in 'Education and Science' (almost 7,000 i.e. over 40% of the total) and 'Health and Children' (over 6,000). In terms of expenditure savings, these two budgets, along with 'Social and Family Affairs' (mainly benefits related), again suffered the largest cuts.
The second report was by the IFS and King's Fund which looked at the knock-on impact for other Departments of protecting the English NHS budget. If the NHS in England is excluded from any proposed cash cuts, the average annual reduction in spending for all other Departments rises from 2.3% to 3.4% between 2011-12 and 2013-14. Furthermore, the authors also estimate that in order to meet demographic pressures up to 2017, average annual real terms NHS funding increases of around 1.1% are required, in order to maintain quality.

Finally, perhaps a lesson from Finland helps reduce the fear of cutting health spending; from 1990 to 2005 health expenditure as a % of GDP fell and yet life expectancy gains were amongst the highest seen in the OECD.

7. Impact of Wage and Council Tax Settlements

(i) Wage Settlement

A recent paper by Professor David Bell for the Scottish Parliament Finance Committee estimates that the wage bill paid by the Scottish Government is around 60% of the Resource DEL, or just over 50% of the entire Scottish Government Budget.

Given the importance of staff costs in the budget, every 1% increase in the Scottish total public sector wage bill in future years will be worth around £150 million per annum. Consequently, if public sector wage inflation where controlled to zero for the next 3 years, real reductions in spending capacity would be substantially reduced, by £450 million over the three years (ie, 1.5% DEL). Moreover, any real terms rises in wages will impose further cuts on non-wage budgets.

(ii) Council Tax Settlement

In 2007-08, the Council Tax raised almost £2 billion in Scotland, equivalent to around 7% of the Scottish Government Budget. Each 1% rise in the Council Tax is therefore worth £20 million. Any extended freezing of this local tax will require additional contributions to local government from the Scottish Government's Budget or yet more levels of efficiency savings and wage restraints to ensure the same level and quality of service is delivered.

If a 2.5% increase in Council Tax was achieved, rather than a continuation of the Council Tax freeze (ie, 0% growth), then this contributes almost £50 million to public sector spending capacity.

8. Specific challenges: Scottish Water and Education

This section takes two important specific sectors and looks at the potential for making savings, in terms of relative spending per head across the four constituent countries of the UK, or for copying money saving practices.

(i) Scottish Education

The first is in relation to education, in particular school education. Scotland's per capita/pupil spend would seem to be well above that experienced in England, Wales or Northern Ireland. It is difficult to obtain precise data for this comparison but the Scottish – English differential would appear to be of the order of 20-30%, although the reason(s) for such a differential are not clear.

The figures in Table 3 confirm that Scottish spending per pupil (or per head of population) is well above that seen in any of the other nations of the UK.

What is even more worrying is that over the last decade this funding gap does not seem to have led to improved relative performance. In terms of examination achievements in the last year of compulsory education, Scotland has stood still while English results have improved markedly. Whilst the education systems differ and the impact of higher spending could be expected to lead to varying results, understanding why such a divergence in outcomes exists could offer opportunities for efficiencies.

Table 3: Spending on primary & secondary education in Scotland, England, Wales & Northern Ireland – 2005-06 & 2007-08 (£)

Spend per pupil		Primary	Secondary
2007-08	Northern Ireland	2,544	3,923
	England	3,580	4,620
	Scotland	4,638	6,326
2005-06	Wales	2,909	3,548
	Scotland	4,138	5,771

Sources: The Primary Review independent enquiry into the condition and future of primary education in England; House of Commons Library Note on Unit funding and expenditure in (English) education; Northern Ireland Assembly Research paper on Primary School Funding; and Expenditure on school education in Scotland, 2007-08 statistics.

The Head of the UK Audit Commission has recently highlighted the need to include Education (and Health) in the search for any Spending Review efficiencies. In particular, the Audit Commission has published a paper which questions the existing efficiency seen in English schools. If that is the case in England then it simply reinforces the case for taking a close look at Scottish spending on schools.

(ii) Scottish Water

The second specific area is in relation to the cost of sponsoring Scottish Water, a service that accounted for over £180 million of the Scottish government budget in 2008-09 or around £545 million for the 3 years 2008-09 to 2010-11. The Scottish

Government receives no Barnett funding from an equivalent budget line in England for this, as water services are delivered outside the public sector in England and Wales. Removing Scottish Ministers as Scottish Water's owner would allow it to have access to private sector funding and in doing so free up scarce public funding for use elsewhere.

The pressures facing the Scottish Government are perhaps highlighted in the most recent WICS report[2]. In determining Scottish Water's charges for the period 2010-14 the regulator indicates uncertainty remains around how much the Scottish Government will support Scottish Water's £2 billion investment programme by way of loans. It has assumed that there will be between £140 and £150 million per annum available. Although this is £30-40 million per annum less than Scottish Water received in the previous 4 years, it still means Scottish Water will be allocated £700 million of scarce Scottish Government funding between 2010-11 and 2014-15. Thereafter, the WICS is indicating it will then require further debt of around £170-200 million per annum, escalating at 5% per annum, if it is to meet Scottish Government's environmental and social objectives. Any shortfall in such funding will mean higher water charges and/or lower levels of investment in Scotland's water and sewerage infrastructure.

Besides the possibility of changing the ownership model, Scottish Water also offers lessons in terms of squeezing out much needed efficiency gains. The regulator describes Scottish Water as "a real public sector success story" having delivered substantial savings since its establishment in 2002. It has delivered a 40% reduction in its operating costs (or £180 million per annum) since then whilst household bills have become the 4th lowest out of 11 water providers in GB, down from 7th in 2004-5.

What has been the catalyst to this remarkable performance? First, Scottish Ministers have explicitly outlined what they believe are Scottish Water's objectives over a 4 year period including where investment in the infrastructure is required, what environmental targets are to be achieved and what are deemed acceptable levels of customer service. Ministers then leave the regulators[3] to define what such objectives mean in terms of measurable outputs. To assess Scottish Water's performance over the 4 year period, the economic regulator (the Water Commission for Scotland) uses extensive and detailed benchmarking data as a means of setting challenging targets for Scottish Water's management to deliver. Scottish Water is free to decide how best to deliver these outputs and its staff are suitably rewarded and incentivised to out performance these targets.

Whilst this approach is not necessarily wholly applicable across all of Scotland's public service provision, some elements have uniform relevance as a means of delivering more from less. Assessment of these Scottish Water lessons may offer possible options as Scotland's public sector seeks to cope with severe budget cuts. (See David Hume Institute Occasional Paper Nos 74 & 76 for a more detailed analysis of the applications of these lessons to Care Services, Waste Management and Social Housing).

---

[2] Water Industry Commission for Scotland, June 2009, The Review of Charges 2010-14, The Draft Determination

3 There are 3 regulators in addition to the WICS; The Scottish Environment Protection Agency (SEPA), The Drinking Water Quality Regulator (DWQR) and Waterwatch Scotland

9. Longer term considerations

In addition to the severe funding pressures that will be faced up to 2013-14, it is also worth looking to the continuing or new pressures that lie not far beyond this date.

FUNDING ISSUES

Long term budget constraints - beyond 2013-14

In their Budget 2009 briefing the IFS predict that the years up to 2017-18 will also be tight. Indeed if, as in the earlier period, reduced spending accounts for ¾ of the further tightening needed (with the remaining ¼ coming from tax revenues) then the UK Government's discretionary spending can expect to rise, on average, by only 1% per annum in real terms over this 2nd 4 year period. This results in a cash-terms increase in DEL budget between 2013-14 and 2017-18 of around £4.7 billion. However, in real terms the 2017-18 estimate is still at or below the level seen in 2008-09; £28 billion compared to the 2008-09 actual of £28.1 billion. (See Table 1.)

Again, the impact of protecting areas like Health, by giving them, say, a 3% real terms increase (still low by historical standards), would be to enforce further real terms cuts on non-Health budgets.

And that is not the end of the story. In 2017-18 the UK's net debt will still be over 70% of GDP. It is expected that the UK government will want this to fall, if not to the old 'Golden Rules' limit of 40% of GDP, then at least to 50%. If so, the IFS analysis suggests that this will take up to 2022-23, to reach 50%, or 2032-33 to reach 40%. Bear in mind too that the UK government's finances will most likely need to deal with a further downturn/crisis over this period, which usually occur every 10-15 years.

SPENDING PRESSURES:

(i) Demographic pressures

Additional budget pressures may arise as a consequence of the current demographic trends facing most countries around the world, including the UK and Scotland.

Recent UK (PriceWaterhouseCoopers) and international (IMF) reports have highlighted the importance to future government budgets of the impact of an ageing population. The budgetary implications of the current fiscal crisis start to coincide with the timescale for the demographic 'crisis' highlighted recently by the International Monetary Fund (IMF). In fact the IMF states that *"In spite of the large fiscal costs of the crisis, the major threat to long-term fiscal solvency is still represented, at least in advanced countries, by unfavourable demographic trends."* The IMF has highlighted the large impact of these demographic trends on health and health care by 2050, but the fiscal costs will start to emerge well before 2050.

The General Registrars Office for Scotland (GROS) has made population projections up to 2031[4] for Scotland as a whole (as well as for each local authority) and these have been broken down into age groups, as shown in Table 4 below.

The elderly Scottish population rises steadily, from 16% in 2006 up to 25% in 2031. As this is a Scottish average it hides very high elderly population ratios within some Local Authorities, e.g. from, in 2031, a low of 19% in Glasgow to highs of 32% in East Dunbartonshire and 35% in Dumfries and Galloway.

Equally, the ONS predict that, across the UK, Scotland and Wales will show the biggest increase in the % of population aged 65 and over between 2007 and 2017. In Scotland this moves from 15.5% in 1997 to 16.4% in 2007 to 19.5% in 2017. By way of contrast London is virtually unchanged, at 11.8%, over the latter period.

Table 4: Projected Scottish population (2006-based) by age group (%)

Age groups	2006	2011	2016	2031
0-15	18	17	17	16
16-64	66	66	64	59
65+	16	17	19	25

Note: those aged 65+ is only an approximation of % of the population of pensionable age due to definitional changes to pensionable age over time caused by upcoming government legislation.

With regards to **Long Term Personal Care Costs for Older People** in particular, the estimates from Lord Sutherland's Independent Review in 2008 are that the cost of providing this will increase from around £256 million in 2006 to £393 million by 2016 and on to £800 million by 2031. In wider terms, overall Long-Term Care Costs were estimated to rise from £2.23 billion in 2006 to £3.27 billion in 2017 and to £6.38 billion in 2031. Much of these are currently inescapable pressures that the Scottish and local government's have to meet and as such raises the pressure on other budgets which may have to be cut to an even greater extent.

Overall, both the UK and Scottish governments will be under strong pressure to boost the budgets relating to health, pensions and long-term care. To meet some of these pressures the budgets for, amongst others, non age-related local government funded services may well be cut.

(ii) Climate change pressures

The ambitious UK and Scottish targets on climate change will have implications for budgets in terms of funding the changeover to greener ways of living. This will cover a variety of service areas, from home insulation through public transport to energy provision.

The UK's proposals for a Low Carbon Transition Plan were outlined on the 15th July 2009 and suggest that, as a result of such targets being met, household and business bills will rise by 8% and 17% respectively by 2020. Clearly this will also have an impact on government energy bills.

[4] Projections were made in 2008 and based on 2006 data.

Once again, this is currently an inescapable pressure that the Scottish and local government's have to meet and so raises the pressure for compensating cuts in other budget areas.

All of the above suggests the impending budget pressures are unlikely to disappear any time soon.

10. Illustrations of the major challenges facing Central and Local Government

Given the warnings contained in earlier sections of the impact of making concessions to particular areas of spending, it is worthwhile quantifying their impact. So, for example, within an overall **-8.5%** budget cut:

i) if there were no cut in Health in Scotland this would result in a **-13%** cut in all non-Health services
ii) if there were no cut in the total wage bill in Scotland this would result in a -17% cut in all non-wage related services
iii) if there were no cut in Health or in the total pay bill in Scotland this would result in a -25% cut in all non-Health, non-wage related services
iv) if there were no cut in Health or Education or in the total pay bill in Scotland this would result in a -40% cut in all non-Health, non Education, non-wage related services

(Note: both iii) and iv) adjust to avoid double counting of Health and Education wage bills, by assuming that 50% of their budget is wage related.)

These examples of concessions, some of which seem bound to be realised to at least some extent, only heighten the importance of challenging some current practices. As a result of the pressures alluded to in this report there will be a series of major challenges which both central and local government decision makers will need to face up to:

- prioritizing service outputs rather than service inputs
- limiting pay increases in order to minimize job losses
- facing up to public and interest group pressures
- reconfiguring service delivery
- reconfiguring the map of service delivery i.e. number of Local Authorities, Police and Fire Authorities, Health Authorities, non-departmental bodies and inspection/regulation bodies etc
- making policies that are mindful of future problems and do not exacerbate them
- improving challenge functions and the use/knowledge of evidence based policy
- the ability, expertise and capacity of Finance Departments to identify and help introduce the necessary efficiencies and service reforms.

Perhaps one of the biggest necessary shifts in mind-set is to move the focus of political debate away from inputs and towards outputs and outcomes. Moving the debate away from class sizes, NHS spend and police numbers to attainment, healthy living and neighborhood security will not just widen the scope for policy debate it will also widen the scope to make efficiency savings by removing unnecessary restrictions on how services can be re-thought and reconfigured.

11. Summary and Conclusions

A very brief précis of this report highlights the upcoming budgetary landscape that faces all levels of government and impinges on policy decision making.

The basic position is one of real terms cuts of 2.3% or more a year from 2011-12 to 2013-14, resulting in a cut in the Scottish budget of £2.5bn, or -8.5%, from the 2009-10 total.

These cuts will be HIGHER, at least in some areas, if:

- growth in the UK economy is slower than expected or if UK interest rates are higher than at present
- Scottish health and/or education budgets are protected
- wage settlements do not share in this fall
- current policies in relation to Long Term Care, Climate Change and demographic ageing are unchanged

There remains uncertainty over the full extent of the decline but not over the direction of travel.

- A new age of austerity looms and very little time exists to prepare for it. Many of the potential areas for larger savings will take time to implement and so radical ideas too need to start to be addressed now. It would seem essential therefore to start to plan now for these likely budget reductions and look upon any future upturn as a welcome bonus.

- One lesson to be learnt from the above examples is that for every concession that is made, be it to Health, on the total public sector wage bill or wherever, then this simply turns the screw on every other sector that does not benefit from the concession. As a result, it would be relatively easy to move from a position of across the board cuts of 8.5% in real terms by 2013-14 to one where some areas were exempted but the remainder were facing cuts of twice that size.

- Central government may seek to balance the budget by cutting directly, or indirectly through assumed higher efficiency savings. However, unless these efficiency savings can be achieved they will simply result in a higher level of cuts.

- Spending areas and ideas that were once taboo will be no longer. A detailed review of all budgets is essential in order to minimize the on the ground impact of these reductions and to ensure the maximum efficiency possible in relation to outputs for given inputs.

- Part of the above exercise will need to involve comparisons with how efficiently comparable services are being delivered elsewhere.
- The downturn in budgetary prospects is set to be deep and to be prolonged. Wherever possible, preparations for these austere times are likely to improve the effectiveness of the final budgetary decisions made.

12. References

Armstrong J, David Hume Institute, - Occasional Paper 74, "Improving productivity in Scotland's public services"
- Occasional Paper 76, "Improving productivity in Scotland's public services, Policy Lessons"

Audit Commission – Valuable Lessons, Improving economy and efficiency in schools, July 2009

Bell, D. – The UK Budget Position and Strategic Implications for Public Services in Scotland, Scottish Parliament Finance Committee paper April 2009

CPPR Briefing Note April 2009 – Post Budget 2009 update of the Scottish Government's Budget – growth scenarios up to 2013-14

Department of Energy and Climate Change – 'The UK Low Carbon Transition Plan', July 2009

General Registrars Office Scotland – 2006-based sub-national projections for Scotland (2008)

H.M. Treasury - Budget Report, 2009

House of Lord's Select Committee on the Barnett Formula Report, HL Paper 139, July 2009

IFS - Green Budget Report 2009
- Budget Analysis Report 2009
- & King's Fund – How cold will it be? Prospects for NHS funding: 2011-17, July 2009

IMF – State of Public Finances: Outlook and medium term policies after the 2008 crisis, 2009

Irish Government - Report of the Special Group on Public Service Numbers and Expenditure Programmes, July 2009

Population Trends 136, Subnational patterns of population ageing, ONS 2009

Price Waterhouse Coopers – With public debt rising so high, how can we meet the fiscal costs of an ageing population? May 2009

Scottish Government - Finance Circular No. 1/2008
– Draft Budget 2009-10, September 2008

SPICE Finance Committee – Strategic Scrutiny of the Scottish Government's Budget – Scoping Paper, April 2009

Sutherland, Lord – 'Independent Review of Free Personal and Nursing Care in Scotland', 2008

13. ANNEX A

Assumptions behind the budget estimates shown in Table 1

Figures in Table 1 are based on the following assumptions:

- DEL cash figures (first line of data) to 2010-11 are taken from Table 3 of the Finance Committee Scoping Paper – Strategic Scrutiny of the Scottish Government's Budget; SPICE, 29/04/09

- all real figures (data line 2) are devised by applying the GDP deflator (taken from Table C1 of Annex C of the Budget Report 2009) to the cash data

- real terms growth rates (data line 4) for years 2011-12 to 2013-14 are taken to be as calculated by the IFS in their post Budget 2009 analysis, that is -2.3% per annum

- real terms growth rates for years 2014-15 to 2017-18 (+1% real p.a.) are also derived from the IFS analysis post Budget 2009. The 1% figure assumes that in order to accommodate the 3.2% of national income fiscal tightening pencilled in for 2014-15 to 2017-18, and assuming ¾ of this came from spending rather than taxes, then real spending growth would amount to around 1%.

- the decline in real terms DEL for 2011-12 is greater than 2.3%, as the DEL baseline in 2010-11 needs to be adjusted to exclude non-recurring budget amounts. This reduces DEL in 2010-11 by £0.26b; £0.17b from the EYF reserves that have already been drawn down for that year and £0.09b from a budget over allocation allowance.

Earlier CPPR reports illustrated the impact of three different scenarios for future DEL spending totals:

- **Scenario A** – IFS "Scotland". This scenario is based on the IFS's Green Book (IFSGB) real growth rate for Scottish DEL of –1.5%, taken from IFSGB, 2009 (see Chapter 9, Figure 9.10), updated for their more pessimistic Budget '09 calculations (see IFS Budget 2009 briefing, 'Public Spending" by Gemma Tetlow), giving a new real growth rate of -3.8%;
- **Scenario B** – IFS 'UK average'. This assumes a real growth rate of -2.3%. (Again by updating the 0% real growth rate that IFSGB assumes for UK DEL as a whole with their post Budget 2009 analysis for DEL);
- **Scenario C** – CPPR's 'Barnett related'. CPPR's own calculations of Scottish growth is based on applying the Barnett Formula to the IFS growth rates for Whitehall Departments which comes out at -1.8% average annual growth. (Again this updates the 0.5% real growth rate that IFSGB assumes for UK DEL as a whole with their post Budget 2009 analysis for DEL)

Much greater detail of how the IFS growth rate is arrived at can be found in Chapter 9 of their Green Budget Report 2009 publication (although data refers to PBR 2008 as opposed to BR 2009). However, the brief explanation is as follows:

- The PBR08 set overall Total Managed Expenditure (TME) [5] increases at 1.1% per annum in real terms over the period 2011-12 to 2013-14[6]
- Non-DEL elements of TME – principally net debt interest payments and social security related benefits – are set to rise more quickly, i.e. by 2.5% a year, and with the TME growth rate limited to 1.1% pa, this implies the remainder of spending (effectively DEL) experiences a 0% real growth rate over the period
- IFS then average this zero real growth across all spending Departments by applying an equal percentage point reduction in their annual growth rate for the period 2011-12 to 2013-14
- This means in effect that each Departments' growth rate from 2010-11 to 2013-14 is reduced by 2.5% from that experienced over the earlier period 2007-08 to 2010-11, so that traditionally high growth Departments (like Health) still grow but at a lower rate than before, while many low growth Departments experience real term reductions over the later period
- The Scottish DEL Budget falls into this latter category and so experiences a real terms annual decline of 1.5%[7].

---

[5] Total Managed Expenditure comprises Departmental Expenditure Limits (DEL) and Annual Managed Expenditures (AME). The Scottish Government's discretionary spending budget is DEL. AME includes items that are not within the control of the Scottish (or indeed the UK) Government including, in the main, social security payments and tax credits.

[6] IFS also indicate that current spending is expected to rise by 1.2% pa on average over the period whilst capital spending will be held constant in cash terms, and so falling in real terms. Given the importance of capital spending to the Scottish budget, the budgetary implications of this variation is something we expect to analyse in a future briefing.

[7] The figure of 1.5% is actually lower than the 2% seen in IFSGB Table 9.10, as it has been adjusted to incorporate the efficiency savings cut in 2010-11.

14. ANNEX B

Breakdown by portfolio of spend for 2008-09, £ billion

Scottish Government DEL		%	Local Government		%
Office of First Minister	0.3	1	Education	4.3	46
Finance & Sustainable Growth	2.6	9	Social Work	2.1	23
Health and Well-being	11.2	40	Police & Fire	1.4	15
Education and Lifelong learning	2.6	9	Roads and Transport	0.4	4
Justice	1.1	4	Leisure & Recreation	0.4	4
Rural Affairs & the Environment	0.6	2	Cleansing & Environment	0.3	3
Local government	9.2	33	Other	0.3	3
Administration	0.3	1			
Crown Office and Proc Fiscal	0.1	-			
Parliament and Audit Sc	0.1	-			
Total	28.1	100	Total	9.3	100

Sources: SPICe Draft Budget 2009-10, September 2008 and 'Green Book' for Grant Aided Expenditure 2008-2011, March 2008.