

## Press Release

### LONG TERM SCOTTISH BUDGET PROJECTIONS

The latest analysis paper by Fiscal Affairs Scotland looks at the long term prospects for the funding of Scottish public services. This subject is likely to dominate the political landscape for some time to come, especially given the magnitude of the future cuts that have to be accommodated by budget holders who have already had to deal with severe financial constraints.

However, as today's Populus survey for the Financial Times reveals, only two in five UK voters believe more austerity and cuts will be needed in the five years after the 2015 election. As our paper shows, this is unlikely to be the case. Rather, deeper cuts in public service funding than have been seen in recent years are likely to return after the next UK election.

#### MAIN POINTS

- For the first decade of the new Scottish Parliament the Scottish budget rose around 5% in real terms a year. However, the second decade of the Parliament coincided with a likely real terms fall in its budget of around -2% a year.
- Our 'baseline' scenario, going from 2009-10 to 2018-19, incorporates the public service spending projections used by the UK Office for Budget Responsibility for later years. This results in an overall cash terms cut to the Scottish budget of just over -4% and a real terms cut of almost -20% over this period. At present (2014-15) the real terms cut since 2009-10 stands at -10%.
- This means that, at present, both Scotland and the UK are roughly half way through the series of annual budget reductions intended by the UK coalition government to take the UK back to a balanced budget.
- The profile of cuts over the full nine years is: two years of deep cuts, followed by four years of milder cuts (where we currently sit), followed by the prospect of three more years of deep cuts.
- Projections from 2015-16 to 2018-19 have the Scottish Barnett Block grant falling by -1.6% a year in cash terms and -3.5% a year in real terms, which is almost the same rate of decline as experienced in the first two years of austerity. Adding in the Scottish government's projections for Non Domestic Rates Income and Council tax revenues means the real terms fall would be ameliorated to -2.7% a year.
- While most of the intended cuts to the Capital budget in Scotland happened in the first two years of austerity (i.e., in 2010-11 and 2011-12), for spending on day-to-day services, the biggest cuts are still to come.

- Continued protection of the NHS budget will result in the cuts to non-protected areas being over 50% higher than that of the average, i.e., nearer -30% over the full period.
- Upside scenarios are possible; (i) if UK austerity measures are tempered and, (ii) the Scottish government takes advantage of its increased borrowing powers. In the event that both such boosts occurred, the budget cuts post 2015-16 could be more reminiscent of the current ‘mild’ phase of austerity rather than a return to the ‘deep cuts’ phase .
- Potential boosts to the UK and Scottish budgets would affect the Capital budget, which could improve dramatically. However, at present, there is no obvious source of extra funding for the day-to-day spending budget and its relatively steep decline looks set to continue.
- Beyond 2018-19, the UK Office for Budget Responsibility expects spending growth to return to more ‘normal’ levels. However, this very much depends on the continuing, highly uncertain, fortunes of the world, UK and Scottish economies.
- The general picture on future austerity is likely to apply regardless of the political circumstances facing Scotland, and regardless of the Smith Commission findings, at least until 2018-19.
- Stronger economic growth will however be the key to ensuring that more widespread real terms increases in the funding of public services are possible, as opposed to the existing preferential increases for some budget recipients at the expense of the rest.

## **GENERAL CONCLUSIONS**

### Coming to terms with fiscal austerity

Both Scotland and the UK are in the midst of a revolutionary change in terms of the path and composition of its public sector budget. This is the first time post-World War II that budgets have declined, in real terms, over an extended period.

We are only half way through this transitional phase and while budgets may then start to rise, most will remain at funding levels very much lower than at their 2009-10 peak.

This means our government’s will also need to think in more ‘revolutionary’ terms about how public services on the future are best provided. We may have to re-set our spending priorities to accord better with what we can afford, or be willing to pay through increases to general taxation. Even the NHS budget, protected as it has been, appears to be under threat, as it tries to keep up with underlying demand pressures and meet key delivery targets.

### Public service reform

Such ‘revolutionary’ thinking by governments will also be necessary in order to determine how future public services will best be provided. In particular, less favoured spending areas may need to get used to a climate where growth in their budgets continues to be sporadic or even non-existent.

The drastic nature of the change in the funding landscape has only partly been recognised by both the public in general and politicians in particular. There is a sense in which the current phase is seen

as a temporary correction before normal service is resumed. As a result, continued, deep cuts after the next UK election may come as a shock to some.

The budget scenarios we describe are likely to apply regardless of the political circumstances facing Scotland. Whether independent, fiscally autonomous or working within some reformed version of the Barnett formula, the severe financial challenges are likely to remain essentially the same. While the future political landscape, north and south of the border, may allow for some degree of easing of such long-term austerity, it seems unlikely that they will affect the general direction of travel.

### **Importance of faster economic growth**

The main driver that could change this outlook is faster economic growth. However, Scotland's growth prospects need to change dramatically for this already difficult fiscal picture not to be compounded in the longer term (post 2030) by an ageing population which requires increased funding for health and age-related public services.

#### **Quotes:**

##### **John McLaren, Executive Director:**

*“For the first decade of devolution public services in Scotland benefitted from unusually large annual increases in the level of funds available. This feast turned into a famine in the devolved Parliament’s second decade, with budgets seeing year-on-year cuts on an unprecedented scale. At present we are only half way through this period of rapid adjustment. Future cuts, coming as they do on top of already deep retrenchment of budgets, and being concentrated on day-to-day spending rather than on investment, may be even harder to manage than in the past.”*

##### **Jo Armstrong, Executive Director:**

*“Our analysis shows that the rather bleak outlook for public services funding in the near term is unlikely to be reversed by any constitutional rearrangements arising from the Smith Commission recommendations. While there may be better news for the capital budget should the Scottish and UK governments deliver on potential investment promises, these are unlikely to reverse historically large cuts in day-to-day spending that are looming post the UK election. Scottish budget holders planning next year’s spending plans may also need to start considering the longer term implications of these continued budgetary pressures.”*

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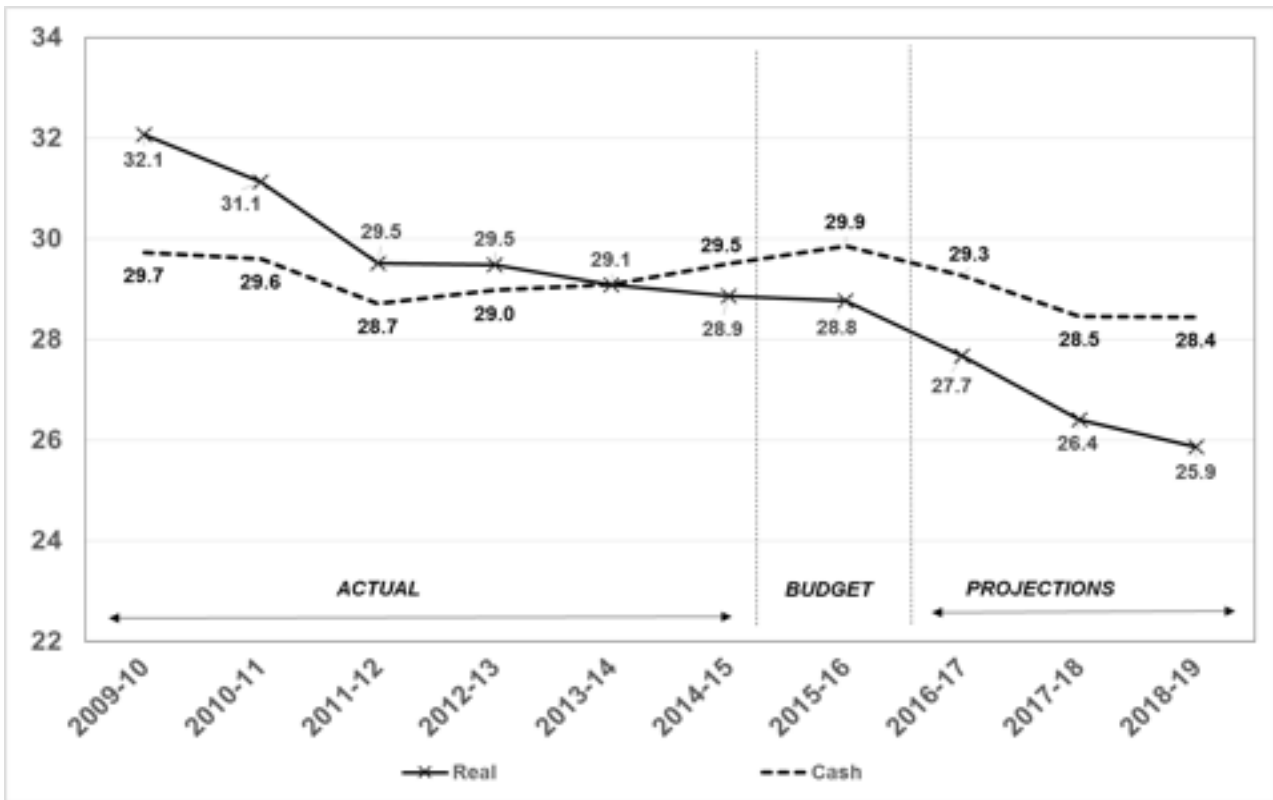
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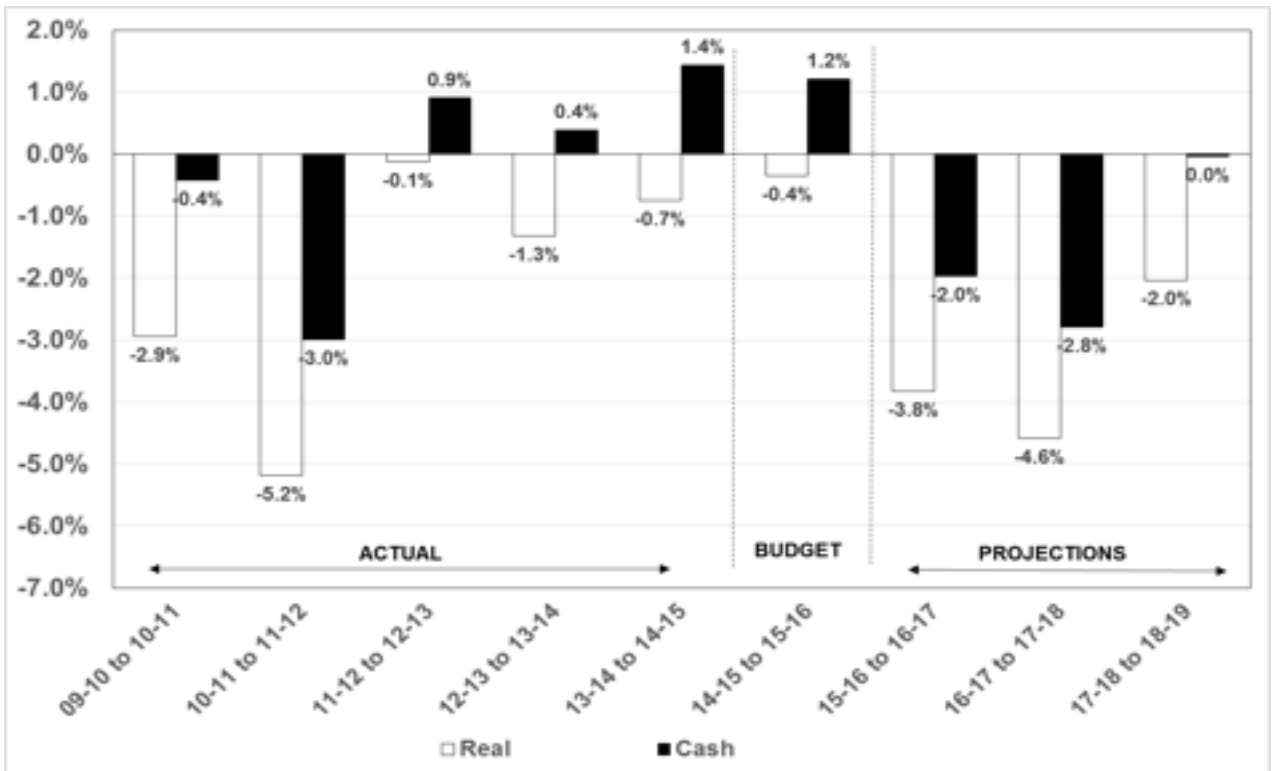
**Figure 1: Scottish Barnett Block Grant, £billion (cash and 2013-14 prices)**



Sources: Actual and Budget - Scottish Government; Projections - own calculations

Note: The Barnett Block Grant excludes both Non Domestic Rates Income & Council Tax revenues.

**Figure 2: Annual % change in Scottish Barnett Block Grant, 2009-10 to 2018-19**



Sources: As for Figure 1

**Table 1: Changes to the value of the Scottish budget, 2009-10 to 2018-19, (%)**

		<b>First period 2009-10 to 2014-15</b>	<b>Second period 2014-15 to 2018-19</b>	<b>Total period 2009-10 to 2018-19</b>
<b>1</b>	<b>Block Grant (cash)</b>	-0.7	-3.6	-4.3
<b>2</b>	<b>Block Grant (real)</b>	-10.0	-10.4	-19.3
<b>3</b>	<b>Full Budget, inc NDRI &amp; CT (real)</b>	-8.4	-8.1	-15.9
<b>4</b>	<b>Protected Block Grant budget (NHS)</b>	0	0	0
<b>5</b>	<b>Non-protected Block grant budgets</b>	-15	-15	-29

Source: Scottish government

**Table 2: Percentage changes to the value of the Scottish budget, 2015-16 to 2018-19**

		<b>Baseline</b>	<b>UK boost</b>	<b>Scottish boost</b>	<b>Combined boost</b>
<b>1</b>	<b>Block Grant (cash)</b>	-4.7	-1.7	-1.7	1.3
<b>2</b>	<b>Block Grant (real)</b>	-10.1	-7.3	-7.3	-4.4

Sources: own calculations, based on IFS and Scottish Government data