

Fiscal Affairs Scotland Monthly Bulletin

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UK ELECTION 2015 SPENDING PLEDGES

Now that the UK election party manifestos have been published we are clearer about what public services are likely to remain protected under the next UK (and existing Scottish) government.

In this respect two budgets in particular are of interest, pensions and the NHS. Both are relatively large and so the implications of their protection could mean significant, negative, knock on effects for other budget recipients.

(a) Pensions

The Conservative Party the Liberal Democrats and the Labour Party are all committed to retaining the existing ‘triple lock’ on UK pensions. This guarantees that state pensions rise at a rate that is the highest of three possible measures; 2.5%, average earnings or consumer price inflation (CPI). It is worth noting that this is in stark contrast to the uprating of other UK benefits, which typically have risen at the rate of CPI, or not at all.

Table 1 below highlights the impact that this has on the future cost of such a guarantee, compared with using CPI as the degree of protection offered.

Table 1: Pensions protection impact

Measure	2015-16	2016-17	2017-18	2018-19	2019-20
CPI (September)	0.2%	1.2%	1.7%	1.9%	2.0%
Average Earnings growth	2.3%	3.1%	3.8%	4.0%	4.4%
Triple lock	2.5%	3.1%	3.8%	4.0%	4.4%
Triple lock less CPI, % points	2.3	1.9	2.1	2.1	2.4
‘Extra’ cost, £ billion (1)	2	4	6	8	10

Sources: Office for Budget Responsibility Economic and Fiscal Outlook, March 2015, Table 4.1

(1) Assumes a State Pension UK bill of £90 billion.

(b) NHS

UK

All UK political parties are signed up to the Stevens’ 5-Year Review of the English NHS to some degree. The Conservative Party, the Liberal Democrats and (implicitly) the SNP have all committed themselves to providing the NHS in England with an extra £8 billion above inflation, as outlined in the third costing example contained within the Stevens’ report.

However, there are a number of reasons to think that this may be a (considerable) underestimate of the full cost of adhering to the Stevens’ Report, as well as of what will be needed to fund new manifesto commitments.

- First, the £8 billion is for England only, adding in Scotland, Wales and Northern Ireland brings the figure closer to £9.5 billion.

- Second, the efficiency gains assumed in the Stevens’ second costings example seem more likely to be achieved than those in the third. This conclusion is partly based on the level of efficiency gains that historically have been achieved. Added to that, existing weaknesses remain, including a continued lack of commitment to increase the degree of spending on prevention measures and to introduce suitable legislation to reduce harmful lifestyle practices, both highlighted by Stevens as key to helping raise the efficiency rate. The resultant, additional, cost for the NHS arising from adopting Stevens’ second costings example is £16 billion for England, or around £19 billion once Barnett consequentials are added.
- Third, the Stevens’ report cost estimates were based on a revised, more cost efficient, structure for the NHS in England. However, this structure does not necessarily fit with that proposed by the political parties. For example, the Conservative Party manifesto has promised to make “*England the first nation in the world with a truly seven-day NHS*”, which is unlikely to come cheap. Equally the Labour Party has its own 10-year plan, which may not tie in with what is proposed by Stevens.

For all these reasons it may well turn out that the increase in NHS funding across the UK by 2020-21 amounts to well over £9.5 billion in real terms (£24 billion in cash terms).

Scotland

The debate in Scotland around the extra funding needed for the NHS has thus far also centred around the model outlined in the Stevens’ report. However, this report may be an inappropriate basis for calculating Scotland’s needs, for a number of reasons.

- The structure of NHS Scotland is different to that seen in England.

- The expected efficiency gains may be higher or lower than what can be expected in England.
- The future aims of NHS Scotland may differ from those of England. For example, in relation to prioritising a 7-day service (Tories), mental health (Lib Dems) or a 10-year plan (Labour).
- Protection in Scotland does not extend, thus far, to GPs in Scotland whereas it does in England.
- Scotland’s demographics are different, with its population ageing faster.

All of these factors suggest that a separate 5-year plan for the NHS, including GPs, is needed in Scotland to determine future financial needs and funding options.

(c) Post election

Overall, the political debate across the UK over the protection of pensions and NHS funding appears to be based more on promises connected to potential electoral success rather than on best practice policies whose repercussions have been properly assessed. These repercussions, given all parties’ commitments to get to some kind of budget balance in the near future, could be severe with regards to the funding available for non-protected areas of public spending.

In the last monthly bulletin we highlighted how various commitments not to raise certain taxes severely constrained what could happen post-election (now upgraded by the Conservative Party to a ‘5-year tax lock’ on income tax, NIC and VAT). This approach tends to preclude the use of higher taxes as an alternative safety valve in releasing some of the pressure on the non-protected services.

JUDGING SCOTLAND'S ECONOMIC PERFORMANCE - WHAT IS THE BEST MEASURE TO USE?

In April the Scottish government published revised figures for Scottish GDP using an updated methodology. Table 2 highlights the variety of ways that GDP can be used to attempt to show how 'successful' the economy has been.

At present, the key statistic used to highlight Scotland's economic performance is real terms GDP. This is the principal measure of overall economic performance used by most countries, including the UK.

However, in Scotland's case it is very much a partial measure of economic success. This is for two reasons. First it excludes the North Sea, which can account for up to 17% of Scottish GDP, and second, it does not adjust for the large degree of non-Scottish ownership in the economy, the profits of which end up outside of Scotland.

For these reasons, judging Scotland's economic success involves studying a number of variables relating to economic performance.

- **Real terms growth in (onshore) GDP** - this is the current standard measure and is useful for gauging the health of the onshore domestic economy. (CURRENTLY PUBLISHED);
- **Cash terms level and growth of total GDP (i.e. including the North Sea)** - this is useful in measuring the tax base of the economy; while parts of Scottish GDP (like the North Sea) may be largely non-Scottish owned, they are still liable for Scottish/UK taxes. (CURRENTLY PUBLISHED);

Table 2: Scottish and UK GDP levels and annualised growth rates (1998 - 2013), using different measures

Measure	Scotland	UK	Scotland less UK
<u>Including North Sea Oil</u>			
Gross Domestic Product (GDP) level (cash terms), £ billion	151	1,713	-
Gross National Product (GNP) level (cash terms), £, billion (1)	143	1,697	-
GDP level (cash terms) per head	28,365	26,723	1,642
GDP growth (cash terms)	4.0%	4.2%	-0.2%
GDP growth (cash terms) per head	3.7%	3.6%	0.1%
GDP growth (real terms) (2)	(-ve)	1.9%	>1.9%
GDP growth (real terms) per head (2)	(-ve)	1.25%	>1.25%
<u>Excluding North Sea Oil</u>			
GDP level (cash terms), £ billion	134	1,690	-
GDP level (cash terms) per head	25,065	26,362	-1,297
GDP growth (cash terms)	3.9%	4.2%	-0.3%
GDP growth (cash terms) per head	3.6%	3.6%	0
GDP growth (real terms)	1.5%	2.2%	-0.7%
GDP growth (real terms) per head	1.2%	1.6%	-0.4%

Sources: Scottish government, Quarterly GDP publication, Quarterly SNAP publication, ONS, Fiscal Affairs Scotland

- (1) For the sake of simplicity, the GDP variants only are shown in the rest of the table. It should be noted that the GNP figure for Scotland is an estimate based on experimental data in relation to the year 2010. In general GNP measures for Scotland are not currently available.
- (2) No exact figure is available for Scotland, but heavily downwards trends in the production of North Sea oil since 1999 suggest that both these growth rates would be negative.

- **Level and growth of total GNP per head** - is probably the best gauge for measuring Scotland's standard of living, and its growth over time. It adjusts for the transfer out of domestic income that ends up abroad and the transfer in of income earned by resident Scots from overseas interests. (NOT CURRENTLY PUBLISHED).

Currently the Scottish government publishes data for cash terms GDP that includes a share of North Sea activity, but does not do so for real terms Scottish GDP. This seems an odd omission given that it remains the 'standard' such measure used by most countries.

Table 2 suggests that this measure would have shown a negative real terms growth rate since 1998, due to the large fall seen in North Sea output, although precise figures are not available. Normally such a fall would have been bad news, but when the output relates to a natural commodity then it is the cash value which is the more relevant measure and the value of North Sea output has not seen a trend fall. However, if we had published this figure perhaps the falling oil production problem would have more urgently addressed and before lower prices exacerbated it. As a result, not to publish such a figure deprives us of a fuller understanding of the complexity of the Scottish economy.

The above discussion focusses on GDP and GNP, although there are many other measures of economic well-being that are pertinent when judging the 'success' of the economy or the country. While this only further complicates the picture, pretending that one simple measure can capture all the vagaries of an economic system is a mistake and greater subtlety needs to be applied when interpreting the success, or otherwise, of Scotland's economy over time.

DIFFERENCES IN THE DRIVERS OF GROWTH BETWEEN SCOTLAND AND THE UK

The latest Scottish and UK figures for GDP highlight that, despite matching growth rates over the past couple of years, the sectors driving this growth have been very different for Scotland versus the UK. This has been little commented upon or analysed. Table 3 highlights some of the major differences.

While both Scotland and the UK have seen fast growth in the Construction sector, the growth rate in Scotland has been double that seen in the UK (19% vs 9%).

The principle reason this has not led to faster growth overall for Scotland is because the sector covering Distribution (retail & wholesale) Hotels and Restaurants has grown much faster in the UK (8.5%) than in Scotland (3.4%).

If these figures are correct then Scotland's recent recovery would appear to be dependent on a more slender economic base than the UK's.

Table 3: Real terms growth in GDP, by sector, 2012 to 2014

	Scotland	UK	Scotland less UK % points
Total	4.6%	4.6%	0.0
Production	2.3%	1.0%	1.3
Construction	19.5%	9.0%	10.5
Distribution, hotels & restaurants	3.4%	8.5%	-5.1
Transport, storage and comm'ns	2.6%	3.9%	-1.3
Business services & finance	7.9%	6.4%	1.5
Government & other services	0.8%	1.4%	-0.6

Sources: Scottish government, ONS

RECENT FISCAL AFFAIRS SCOTLAND PAPERS

The following paper have also been published by Fiscal Affairs Scotland over the past month and are available from our website at www.fiscalaffairsscotland.co.uk.

- Analysis of Scottish GDP measures over time
- Analysis of latest Scottish (Q4 2014) GDP statistics

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