



Public service spending in Scotland: current patterns and future issues

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Background

- IFS carrying out a programme of research on fiscal issues for an independent Scotland funded by the ESRC
 - This is our third major output
 - Follows introductory piece and analysis of benefits spending
- Aim is to explain the current patterns of spending on public services – and how we got here – and the issues an independent Scotland may face on public services
 - Focus is on the short to medium term
 - Future IFS work will look at longer term fiscal issues
- Paul will be talking about some similar issues on the tax side

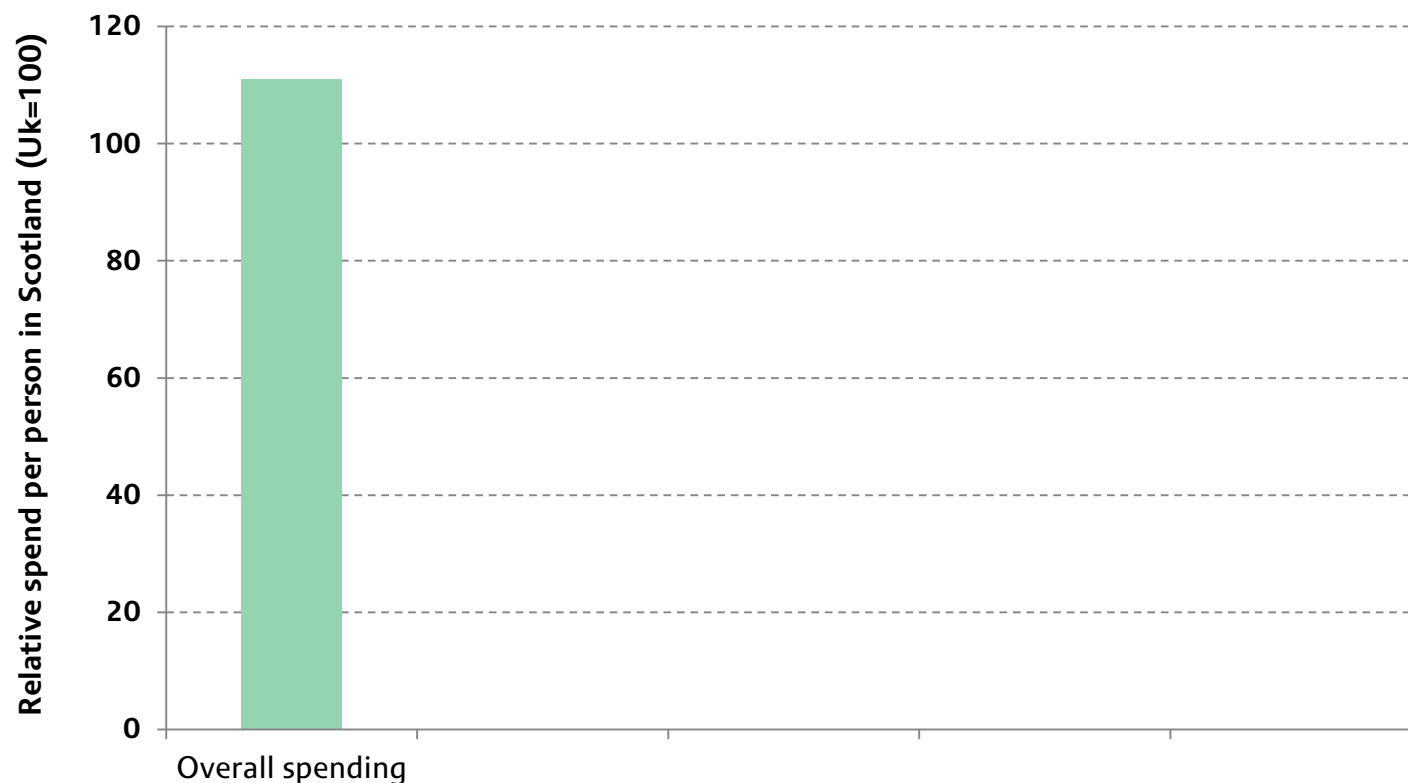
The rest of my presentation...

- Public spending in Scotland – the big picture
- Spending on public services in Scotland
 - Level and composition of spending in 2011-12
 - Changes in spending between 2002-03 and 2011-12
 - Where have the cuts been made?
- Issues for public spending in an independent Scotland
- The potential fiscal picture in the first few years of independence

Before that.. some definitions

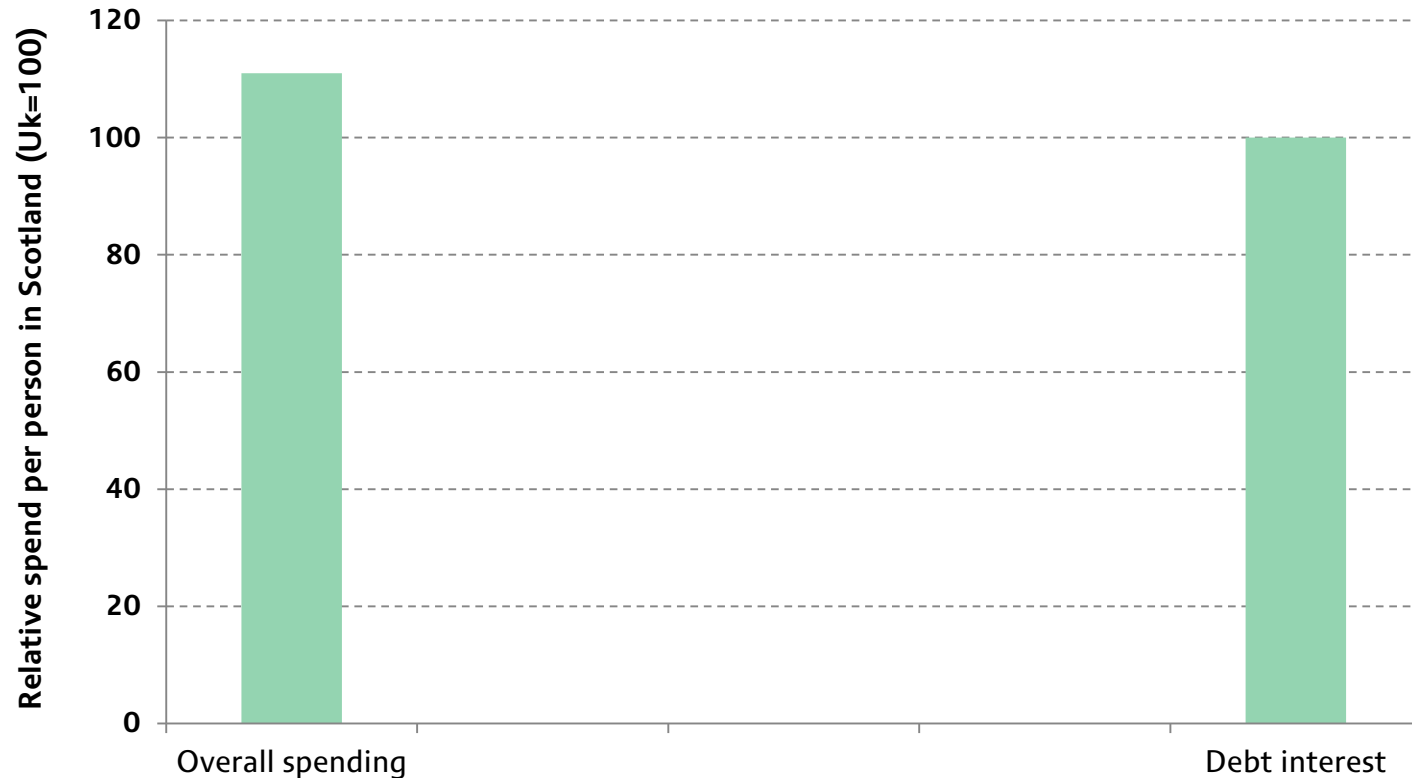
- Use data largely from Scottish government's GERS publication and UK government's PESA publication
- GERS attempts to measure public spending for the benefit of people in Scotland
 - Includes spending by the UK government
- Most spending can easily be identified and allocated to Scotland
- But some spending by the UK government cannot (e.g. defence or debt interest payments)
 - Scotland generally allocated a population-based share
- On this basis, total public spending was £66.9 billion in Scotland in 2011-12 (in 2013-14 prices)

Overall public spending in Scotland was...



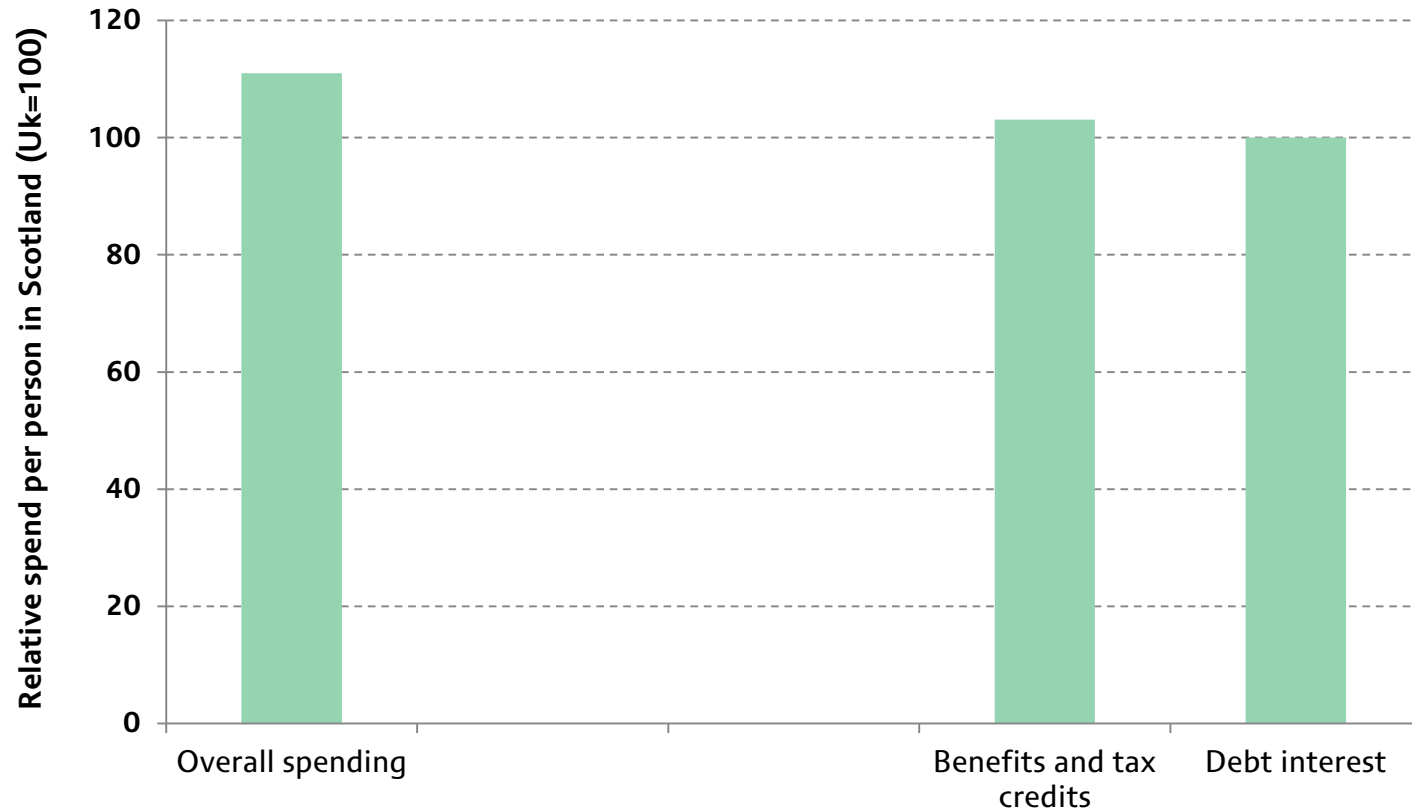
- 11% higher per person than in the UK as a whole in 2011-12

Debt interest spending was



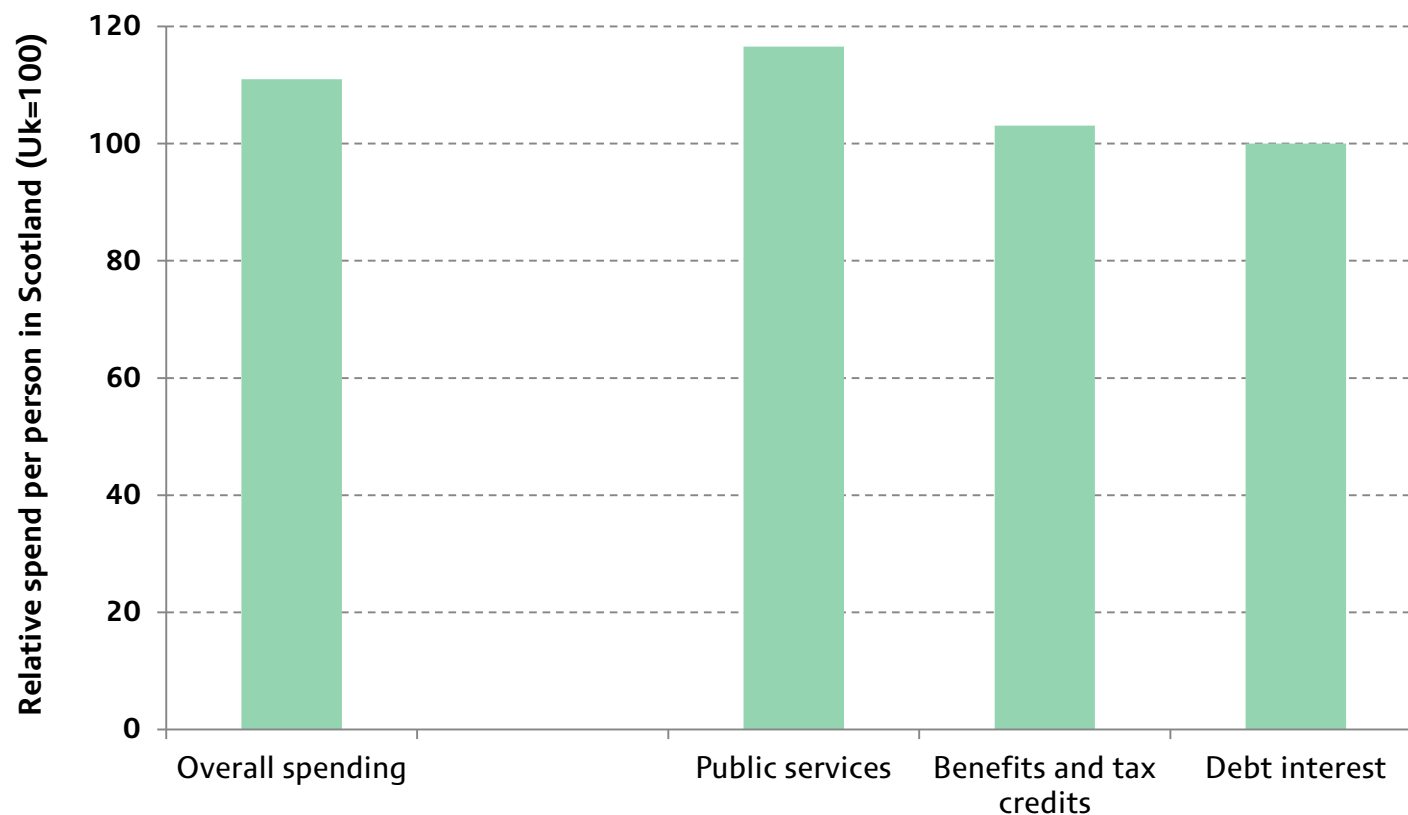
- The same per person (by assumption)

Benefits spending was only a little higher...



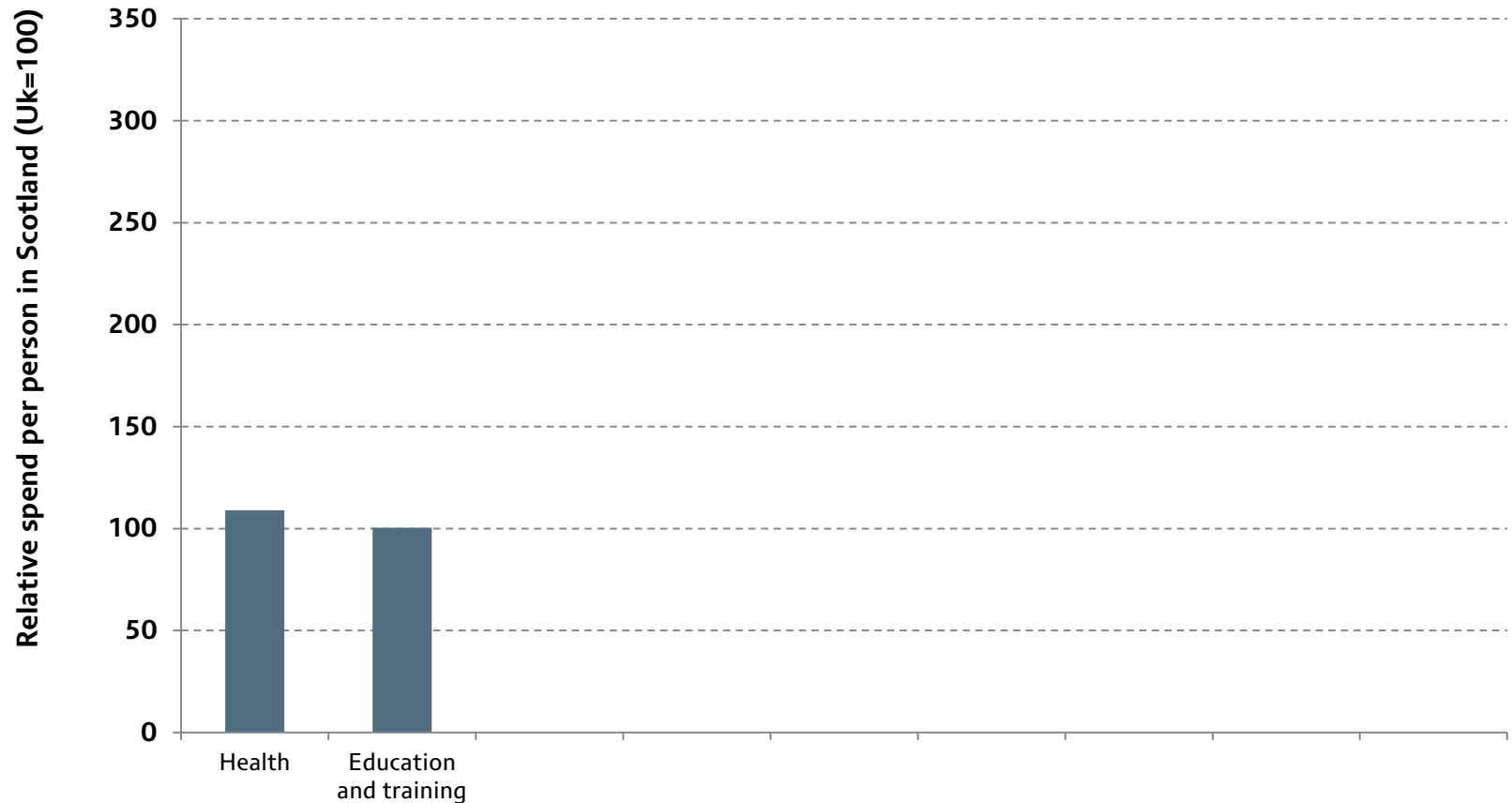
- 3% per person, on average

But spending on public services was...

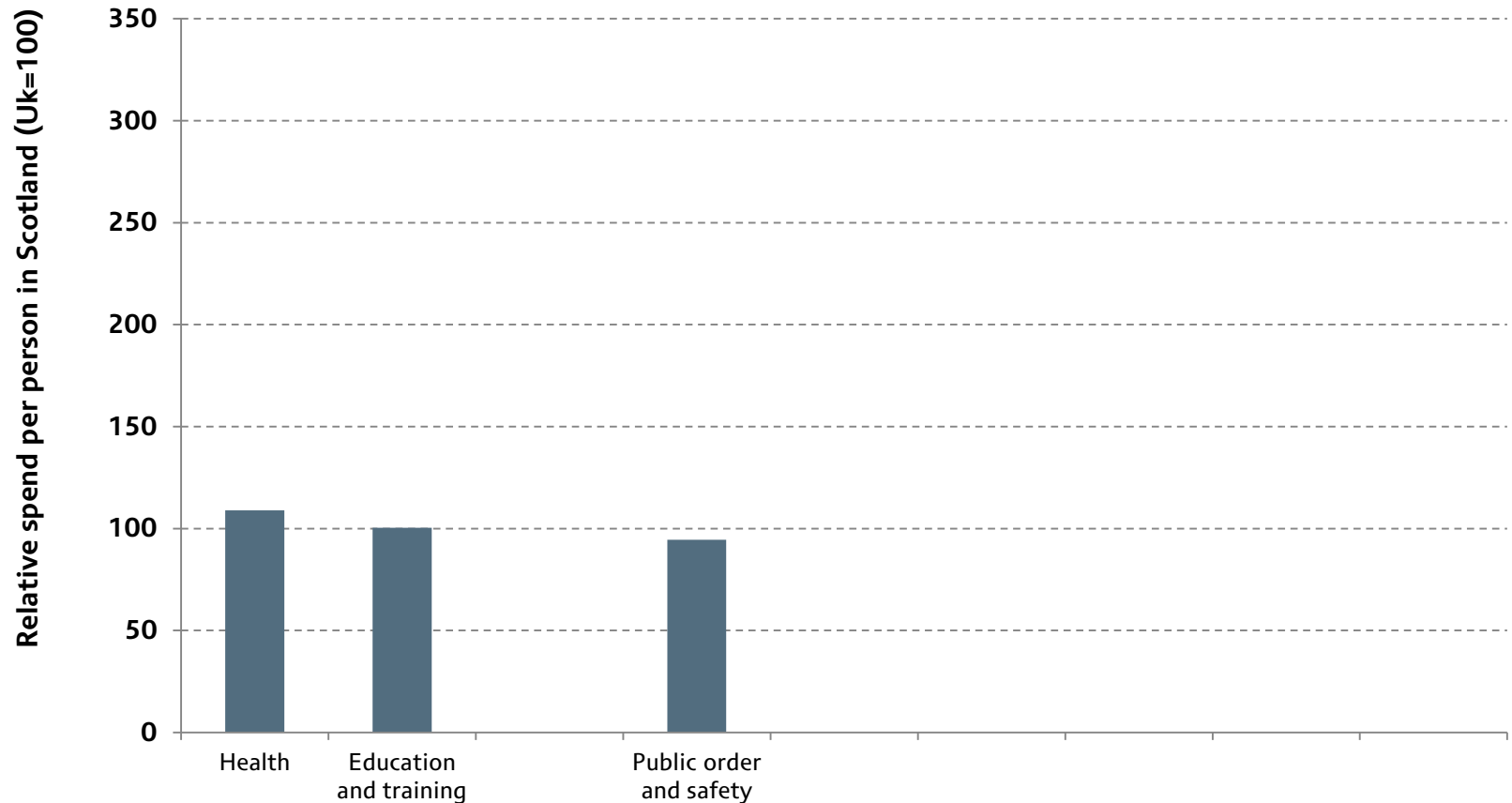


- 17% per person higher in Scotland than the UK average

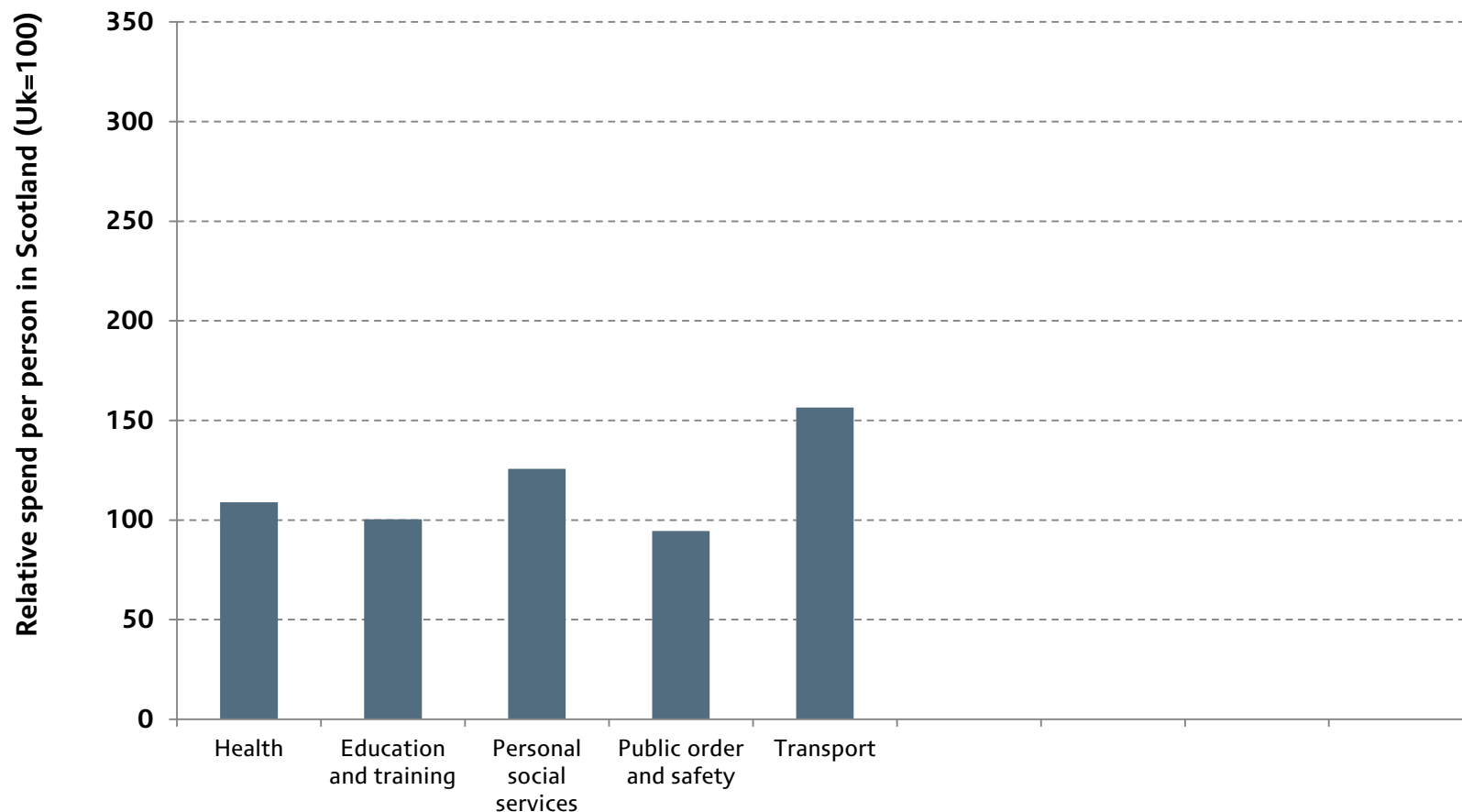
Higher spending not spread equally across services



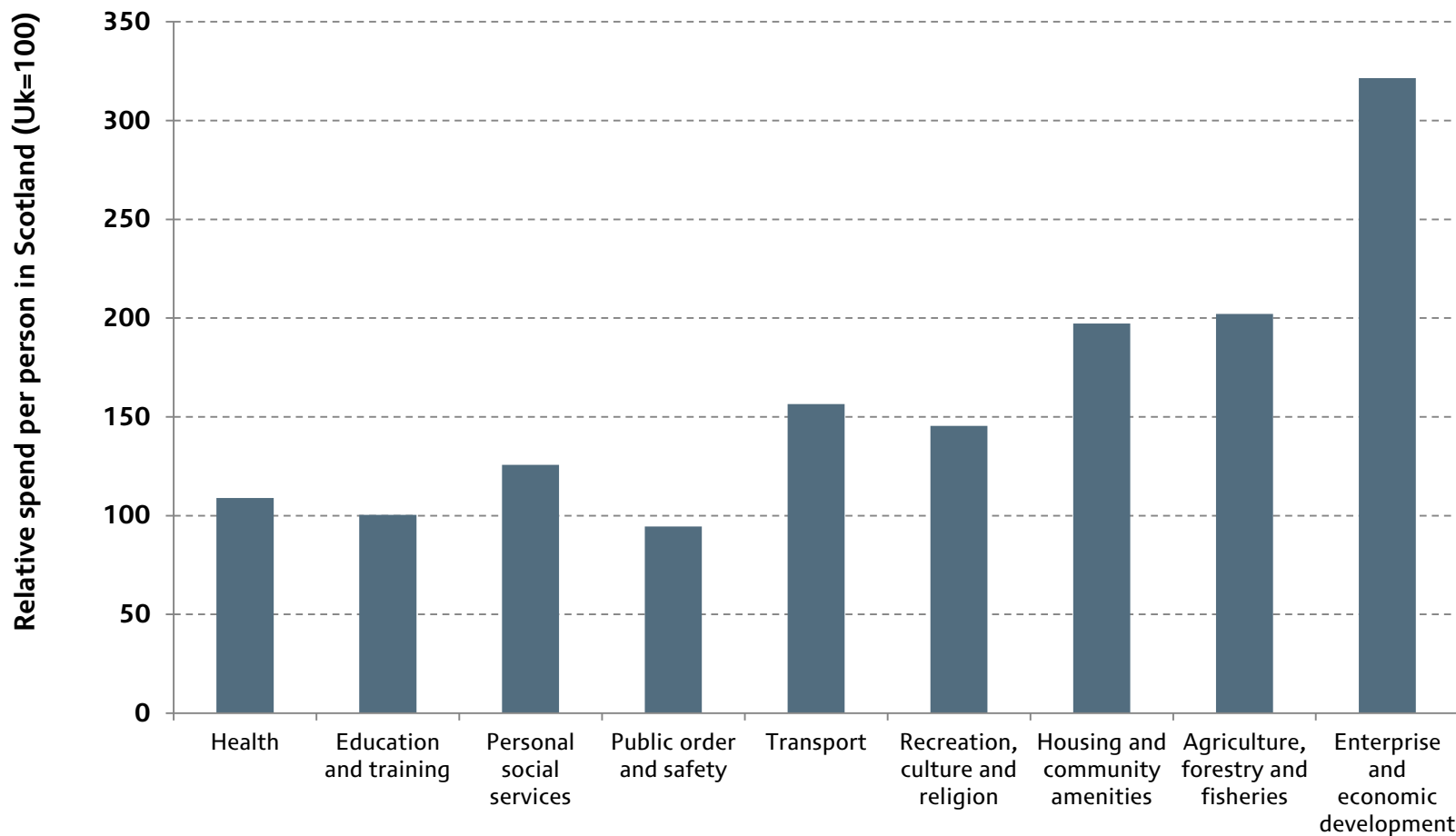
Higher spending not spread equally across services



Higher spending not spread equally across services



Higher spending not spread equally across services



The pattern of public service spending

- These differences in relative spending mean the pattern of public spending is quite different in Scotland to the UK as a whole
- Overall, health, education, law and order, defence and international services take up 71% of spending in the UK
- But only 63% in Scotland.
 - Spending on these averages only 3% more per person in Scotland
 - On other items, the difference is 49% on average
- Capital spending takes up a higher share of public service spending in Scotland
 - Spends more on capital-intensive areas like housing and development
 - Capital share of spending higher for most services too

What explains these differences?

- Analysis of relative spending needs using funding formulae suggests health and school spending needs per person differ modestly (Ball et al, 2012, 2013)
- Policy differences
 - Free personal care for the elderly boosts social services spending
 - Relatively high subsidies to Scotrail and ferry and air services to Highlands and Islands boost transport spending
- The difference in spending patterns has grown over time as the Scottish government has prioritised areas differently
 - Spending on health and education grown less quickly than UK-average between 2002-03 and 2011-12 (but health still up a lot)
 - Spending on other service areas has grown more rapidly than the UK-average

What does this mean?

- Scottish government has been using its powers under current devolution settlement to prioritise spending on particular services differently to the UK government's decisions for England
- But since 2010-11 type of cuts made have been fairly similar to those made by UK government for England
 - Health protected, larger cuts elsewhere
 - Notable exception is housing spend which has been cut a lot in England but not in Scotland
- Scale of cuts being made in Scotland somewhat less than in England and Wales
 - At least in part due to inconsistencies in Barnett formula and the treatment of business rates revenues in Scotland

Issues under independence: defence and aid

- Independence would give Scotland control over areas of spending currently managed by UK government for the whole UK
 - Notably defence and overseas aid
- UK is currently a relatively high spender in both these areas
 - SNP plans cuts in defence spending of about £0.9 billion (just over a quarter)
 - But has an aim of increasing spending on aid by about £0.4 billion a year
- This would leave an independent Scotland...
 - Still spending more of its GDP on defence (1.6%) than most small rich countries (average is about 1.3%).
 - Among the highest spenders on aid relative to GNI (1% compared to average of 0.3%)

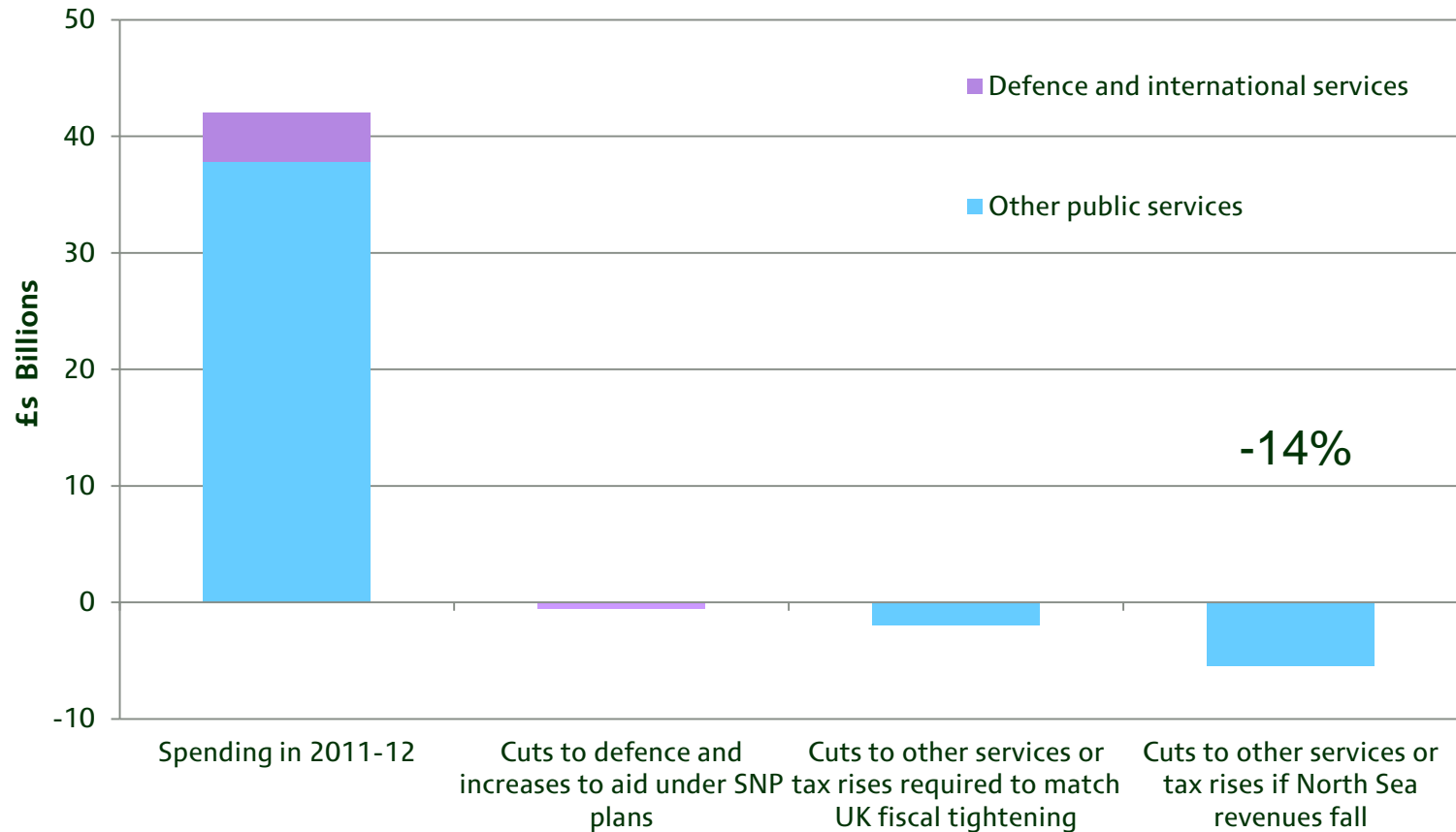
Issues under independence: other services

- Spending per person on services mainly responsibility of Scottish or local governments 19% above UK average
 - Choice of whether to continue with this or not
- If independent Scotland wanted to look for cuts, might expect it to look at areas where it currently spends relatively more
 - e.g. Transport, economic development, housing and social services
- May be upwards pressure on spending on Higher Education
 - Tuition fees must be same (i.e. 0) for those from other EU members
 - Currently up to £9,000 a year for English, Welsh & NI Students
 - Loss of income to universities could be £100 million
- Might expect some loss of scale-economies but these look to be relatively unimportant

Issues under independence: the fiscal context

- Independence in 2016 would be two years before the planned end of the UK government's fiscal consolidation
 - UK planning tightening equal to 1.6% of GDP over two years
- An independent Scotland would have more choice about how to deliver any fiscal consolidation that was needed
 - Tax rises, spending cuts or a mix of the two
 - Equivalent tightening equals about £2.5 billion in today's terms
- However, under OBR's projections for oil revenues, Scotland's deficit may be 2.2% of GDP higher than the UK's
 - Filling this additional hole would take a *further* £3.4 billion of cuts or tax rises in today's terms

The potential scale of the challenge...



There are other options...

- Concentrating the cuts on services other than health and education would mean cuts of 30% to these other services
- Alternatively cutting defence and aid spending to average and benefit cuts/tax rises of 1.1% of GDP would mean
 - Total cuts to services reduced to 6%
- Shows there is scope for limiting cuts to currently devolved public services by taking more action elsewhere

... and other scenarios...

- If North Sea revenues turn out substantially stronger than OBR forecasts, fiscal situation in Scotland might be stronger than in the rest of the UK
 - At least in the first few years of independence
- In this case, in principle could cut spending or increase taxes by less than if it remained part of the UK
- But doing so might be ill-advised
 - Might want to maintain a stronger fiscal position than the UK
 - Gain credibility in the markets
 - Preparation for longer-term fiscal challenges of ageing population and inevitable decline of North Sea revenues.

Summary

- Spending on public services is 17% higher per person in Scotland than the UK average
 - Much smaller gaps for big services like health and education
 - Much bigger gaps for many smaller services like development, housing, transport, and social services
- This reflects different prioritisation by the Scottish government
- Independence would give Scotland control over all areas of government spending
 - UK is a big spending on defence and aid
- May have to make bigger spending cuts or tax rises under independence due to predicted falls in North Sea revenues
 - Although this isn't certain in the short run