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

Relative spend per person in Scotland (UK=100)

- Health
- Education and training
- Public order and safety
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...

- Cuts to defence and increases to aid under SNP plans
- Cuts to other services or tax rises required to match UK fiscal tightening
- Cuts to other services or tax rises if North Sea revenues fall

Spending in 2011-12

£s Billions

-14%
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