Introduction

This report provides an overview of Scottish Government research on the outlook for the UK public finances and the implications for future expenditure by the Scottish Government. It passes no judgement on the wisdom or otherwise of the UK Government’s plans. It, rather, details under a number of scenarios the implications for Departmental Expenditure Limits and in particular the Scottish budget.

The financial crisis and subsequent recession have placed significant strain on the public finances throughout developed economies. The impact has been particularly severe in the UK, with public sector net borrowing in 2009/10 and 2010/11 amongst the highest in the OECD.

To address this, the UK Government intends to engage in a period of considerable fiscal tightening, either through tax increases, spending cuts or some combination of both.

While exact details of the size and composition of tightening in the UK are not yet known, it is clear that public spending will be subject to a period of significant constraint in the years ahead. Scottish Government expenditure will not be immune from these pressures.

This report, produced by the Office of the Chief Economic Adviser, uses recent public finance data, information from external sources and a range of assumptions where necessary, to provide an initial outlook for Scottish Government expenditure beyond 2010/11.
Preface

This report provides an overview of the outlook for the UK public finances and the implications for future expenditure by the Scottish Government.

The financial crisis and subsequent recession have put significant strain on the public sector balance sheets of a number of countries. The UK has been particularly affected, with net borrowing amongst the highest in the OECD.\(^1\)

Budget 2010 estimates that over 70% of UK public sector borrowing in 2009/10 is structural. This means that it will not fall even when the economy recovers. Therefore, a significant period of discretionary policy tightening (tax increases, spending cuts or a combination of both) is planned to bring borrowing down to pre-recession levels.\(^2\)

While the Fiscal Responsibility Act establishes the overarching framework for consolidation in the UK, the exact implications for taxation and public spending have yet to be fully set out. Given the scale of the challenge, it is clear that public spending will be under considerable pressure over the next few years. This makes forward planning vitally important.

HM Treasury have yet to publish a detailed spending programme for beyond the current financial year. No information has been provided for the composition of spending across UK departments. Notably, expenditure allocations for Scotland are not available beyond 2010/11.

In the light of this, this report provides initial estimates of the potential impact on Scottish Government spending from the planned UK fiscal consolidation. Given the lack of detail that currently exists, a range of assumptions and estimation techniques are applied. This necessarily generates a degree of variability within the results and they should be viewed accordingly. A full discussion of the methodologies used in the report is provided in the accompanying annexes.

The development of this research is an ongoing process and feedback is welcome. Please address any comments to –

Office of the Chief Economic Adviser,
St Andrew’s House,
Regent Road,
Edinburgh, EH1 3DG

\(^1\) Source: OECD Economic Outlook November 2009
\(^2\) Source: Budget 2010, page 22 (HM Treasury)
Report Summary

The financial crisis and subsequent recession have created an estimated **structural deficit in the UK public finances worth over 8% of GDP**. It is planned to reduce this deficit by a period of sustained fiscal tightening (tax increases, spending cuts or a combination of both).

While the Fiscal Responsibility Act has established the broad parameters to govern the path to restoring net borrowing and net debt to more sustainable levels, the detailed implications for taxation and public spending have yet to be set out.

The analysis in this report takes Budget 2010 projections for UK public spending and the UK economy alongside the Fiscal Responsibility Act as a basis for informing an assessment of the medium term outlook for UK and Scottish Government public spending. As the UK Government has yet to publish its detailed plans for public spending beyond 2010/11, the analysis relies upon the estimation of a number of key fiscal aggregates. This necessarily generates a degree of variability within the results and they should be viewed accordingly.

**Planned Fiscal Adjustment**

The Fiscal Responsibility Act requires that UK public sector net borrowing is reduced by at least half by 2013/14 and that UK net debt is reduced as a share of GDP from 2015/16.

The Institute for Fiscal Studies (IFS) estimate that the UK Government plans to implement fiscal tightening cumulatively worth 3.4% of GDP by 2014/15, and 4.8% of GDP by 2016/17.
Provided that the growth forecasts which underlie the public finance projections are achieved, HM Treasury expect this tightening to be sufficient to return net borrowing to pre-recession levels and reduce net debt to 70% of GDP by 2017/18, as illustrated in chart A1.

![Chart A1: UK Public Finance Projections](chart.png)

**Public Spending in the UK**

Consistent with these forecasts, Budget 2010 projects that total public spending in the UK, **Total Managed Expenditure (TME)**, will remain flat in real terms up to 2014/15.

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>TME</td>
<td>5.2%</td>
<td>2.2%</td>
<td>-0.2%</td>
<td>-0.1%</td>
<td>-0.3%</td>
<td>0.4%</td>
</tr>
<tr>
<td>Current Expenditure</td>
<td>5.4%</td>
<td>4.2%</td>
<td>1.3%</td>
<td>0.5%</td>
<td>0.3%</td>
<td>0.4%</td>
</tr>
<tr>
<td>Gross Investment</td>
<td>3.6%</td>
<td>-15.6%</td>
<td>-16.3%</td>
<td>-8.2%</td>
<td>-8.8%</td>
<td>1.6%</td>
</tr>
</tbody>
</table>

Table A1 reveals that the level of funding for public sector capital investment will bear a significant burden of the planned consolidation. Budget 2010 outlined average real-term reductions of 7.9% per annum in Gross Investment between 2011/12 and 2014/15. Over the same period, Current Expenditure is estimated to grow by an average 0.6% a year in real terms.

However within these aggregates, it is anticipated that there will be a significant increase in elements of expenditure directly associated with the downturn, including increased debt interest payments and higher social security spending.
Consequently, the resources available to fund general public services such as health, education, housing and transport will be reduced.

The UK Government has not published its plans for departmental budgets beyond 2010/11. Therefore, chart A2 summarises the projections for total UK Annually Managed Expenditure (AME) and Departmental Expenditure Limit (DEL) spending up to 2014/15 estimated in this report.

<table>
<thead>
<tr>
<th>% Real Annual Change</th>
<th>2009/10</th>
<th>2010/11</th>
<th>2011/12</th>
<th>2012/13</th>
<th>2013/14</th>
<th>2014/15</th>
</tr>
</thead>
<tbody>
<tr>
<td>AME</td>
<td>-6%</td>
<td>-4%</td>
<td>-2%</td>
<td>0%</td>
<td>2%</td>
<td>4%</td>
</tr>
<tr>
<td>DEL</td>
<td>-8%</td>
<td>-2%</td>
<td>0%</td>
<td>2%</td>
<td>4%</td>
<td>6%</td>
</tr>
</tbody>
</table>

Source: Derived from HM Treasury- Budget 2010, table C9 and Scottish Government calculations

UK AME is estimated to increase by 3.4% on average in real terms between 2011/12 and 2014/15, largely reflecting projected increases in debt interest payments and social security spending. As a result, UK DEL spending is projected to fall by 3.0%, on average, in real terms, each year between 2011/12 and 2014/15 to achieve the overall freeze in TME projected in the 2010 UK Budget. Together with the changes already taking place during 2010/11, this will represent the first five years of consecutive contraction in real expenditure on public services since current records began in 1948/49.

The projections published in the 2010 UK Budget forecast an additional two years of fiscal tightening worth a cumulative 1.4% of GDP between 2015/16 and 2016/17. Assuming this additional tightening is shared equally between revenue and expenditure, it could allow modest real terms increases in UK DEL spending during 2015/16 and 2016/17. While this growth would be positive, it would be lower than the expected growth rate in the wider economy.

By 2016/17, it is anticipated that the fiscal tightening necessary to restore the public finances to a sustainable position will have been completed and the economy will

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3 AME covers spending programmes which are not easily predictable and are not subject to firm multiyear limits. DEL covers spending which is planned and controlled across the period of a spending review including programme expenditures. DEL is the principal funding source for public services.

4 IFS (2010) – Green Budget 2010, Pg 196
have returned to trend. Public spending is therefore assumed to grow in line with trend growth in output from 2017/18 onwards. This would allow **annual real increases in total public spending (TME) of 2.5% per annum**. On this basis, UK DEL spending is expected to adjust back to pre-recession levels over a number of years – chart A3.

![Chart A3: UK DEL £ Billions (2010/11 Prices) Illustrative Projections](chart)

**Public Spending in Scotland**

**Between 2000/01 and 2009/10**, the Scottish Government DEL\(^5\) has grown by over 5% a year on average in real terms – chart A4. While this, in part, reflects the transfer of additional responsibilities from Westminster to Holyrood, it also represents a period of sustained real increases in the resources available to fund public services in Scotland.

![Chart A4: Real Annual Growth in Scottish Government DEL](chart)

\(^5\) As with the UK DEL, Scottish DEL is the principle source of funding for public services. It is the primary source of funding for public services and the expenditure which is primarily under the control of the Scottish Government and Scottish Parliament.
However in the light of the outlook set out above, future Scottish Government expenditure will not be immune from the pressures arising from the need to reduce UK public sector net borrowing and UK net debt. Clearly a variety of factors will determine the eventual allocations to fund Scottish DEL spending, not least the performance of the economy, the strength of the public finances and the priorities and choices for expenditure.

It is easiest to highlight the scale of the challenge with an example based on a particular set of scenarios. The analysis here has taken the UK Budget 2010 as a starting point and examines the implications for Scotland which follow from this outlook. We label this as the UK Budget 2010 scenario, simply to reflect the fact that all alternative scenarios are based on changes to the assumptions implicit in this case. This is used to illustrate the overall picture though alternative outcomes are equally possible.

The results set out in this report suggest that if the projected reductions in total UK DEL Budgets outlined in Budget 2010 were shared equally across Whitehall departments, and the Scottish Government received the resulting consequentials, between 2011/12 and 2014/15, Scottish Government DEL expenditure could fall by an average 2.9% in real terms per annum. From the 2009/10 peak, this would imply a five year real-terms contraction in Scottish Government DEL expenditure of 2.6% per annum. Consequently, by 2014/15, the Scottish Government DEL would be £3.7 billion lower in real terms than it was in 2009/10, equivalent to a cumulative decline of 12.4%.

Such a path for public spending would take Scottish Government DEL in 2014/15 back to the level in 2005/06 – chart A5.

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*Under the current funding arrangements, changes in Whitehall spending on policy areas for which responsibility has been devolved, result in direct changes to the funding of the Scottish Budget through operation of the Barnett Formula. The exact impact of changes in total UK DEL spending on Scottish Government DEL spending therefore depends on how any reductions in UK spending are allocated between Whitehall departments.*
Over the medium to long-term, assuming that UK public spending were to grow in line with the path set out above, **Scottish Government DEL expenditure would begin to grow again from 2014/15, but may not return to 2009/10 levels, in real terms, until 2022/23 – an adjustment phase of 13 years - chart A6.** The projections in chart A6 suggest that between 2009/10 and 2022/23, the relative Scottish Government DEL foregone compared to an outturn in which real expenditure remained unchanged at the 2009/10 peak could be as much as £25 billion. One alternative way of interpreting this result is to view this as an average real-terms reduction each year over this 13 year period of approximately £2 billion per annum.

**Alternative Scenarios**

As noted earlier, the analysis summarised above takes the UK Budget 2010 as a starting point to inform the outlook for future Scottish Government DEL expenditure. There are however, a number of important assumptions embedded in this scenario and we highlight the impact of alternatives to these on the key results. There is no central or preferred scenario in this report: it seeks only to set out the range of outcomes that might arise and the key considerations.

Changes to the economic growth assumptions, the extent to which any additional fiscal tightening is focussed on expenditure cuts as opposed to increased taxation and the decision or choice to protect particular areas of expenditure all lead to results which range from the Budget 2010 scenario.
For example, to the extent that certain elements of UK public spending, such as Health and Education, were protected from the scale of the aggregate cuts forecast, the impact on the Scottish Government DEL of reductions in UK spending could be lessened. On the other hand, if this protection was at the expense of other areas of expenditure which themselves carry large Barnett consequentials, the overall benefit may be significantly reduced.

However, as the report demonstrates, altering the assumptions does little to change the key messages that arise from the analysis.

**Summary Conclusions**

While exact details have yet to be announced, the analysis suggests that the Scottish Government DEL may experience five consecutive years of real-terms cuts starting in 2010/11 and it may take a further two years before growth returns to trend. While the precise magnitudes are as yet unclear, the report concludes –

- reductions averaging approximately 3% a year in real terms between 2011/12 and 2014/15 are likely;
- by 2014/15, the Scottish DEL could be between £3½ and £4 billion lower in real terms than in 2009/10;
- it will take a period of sustained adjustment lasting up to 12 to 15 years before 2009/10 levels of expenditure are reached once again in real terms; and
- over this period, Scottish expenditure could cumulatively forego between £25 and £35 billion in real terms compared to a situation whereby the 2009/10 peak level of DEL remained unchanged. The upper end of this scale is more likely if the UK economic recovery was to be slower than forecast in Budget 2010.
Structure of the Report

- Section 1 – Impact of the Recession on the UK Public Finances and the UK Policy Response
- Section 2 – Future UK Public Spending
- Section 3 – Scottish Government Spending
- Section 4 – Impact of Future UK Public Spending Plans on Scottish Government Spending (DEL)
- Section 5 – Impact of Slower UK Economic Growth on the Public Finances
- Section 6 – Further Alternative Scenarios

Structure of Report

This report provides an initial outlook for Scottish Government DEL expenditure for the probable period of the next UK Comprehensive Spending Review (CSR) and beyond.

The report begins with a discussion of recent trends in the UK public finances and the impact that the recession and financial crisis have had on the UK’s fiscal position. It then proceeds to outline the measures the UK Government has committed to introduce to bring public sector borrowing down to pre-recession levels.

Section 2 discusses the UK Government’s plans for aggregate public spending over the five years up to 2014/15 contained within Budget 2010 and presents an illustrative example of how public spending could evolve beyond 2014/15. Sections 3 and 4 outline recent trends in Scottish Government spending, and provide illustrative estimates of how this may evolve over the coming years based on the current path of fiscal adjustment set out at the UK level, conditional on the Budget 2010 economic forecasts.

Section 5 discusses the potential impact on the public finances of economic growth being slower than currently forecast by HM Treasury, and the effect this could have on the resources available to the Scottish Government. Finally, Section 6 provides further alternative scenarios to demonstrate the effect that varying some of the
underlying parameters in this analysis would have on the estimates of future Scottish Government spending.
Section 1 – Impact of the Recession on the UK Public Finances and the Policy Response

Overview

Since the start of the global financial crisis in 2008, output has fallen sharply in most economies with the impact shared across industries, businesses and households\(^7\).

One area where this impact has been particularly strong is in the public finances. There are a number of reasons for this. Firstly, the public finances act as an ‘automatic stabiliser’ during downturns. Elements of expenditure, such as unemployment benefits, have increased while some revenue sources, such as income and corporation tax, have fallen. These automatic stabilisers provide temporary support to the economy but come at the expense of a weaker public sector balance sheet.

Secondly, given the severity of the downturn, governments responded to the crisis with a range of additional discretionary stimulus measures. These included temporary tax cuts and one-off capital spending programmes\(^8\).

Finally and most importantly, output in most economies has taken a permanent step-down. Even if trend growth rates are re-established relatively rapidly, this will not fully compensate for the permanent loss to output. The decline in the level of output and subsequent loss of revenues has helped create a large structural deficit.

\(^7\) For the most recent assessment of the performance of the international and Scottish economies see – www.scotland.gov.uk/stateoftheeconomy

\(^8\) In addition, to the extent that some governments were required to provide financial support for their banking systems, this led to further levels of public sector borrowing.
Future Fiscal Consolidation

**Deterioration in Public Sector Balance Sheets**

The global downturn has weakened the financial position of governments across the world. As the chart above highlights, the UK has been particularly affected, with borrowing levels above the OECD average.

Total Managed Expenditure (TME), the principal aggregate measure of public spending in the UK, is forecast to peak at 48.1% of GDP in 2010/11. This will be the highest ratio of public sector spend to GDP since 1982/83.
At the same time, current receipts are expected to have fallen to 36.1% of GDP during 2009/10, the lowest level since 1993/94. The combination of lower receipts and higher expenditure has fuelled a substantial rise in government borrowing.

As chart 3 highlights, UK public sector net borrowing is currently close to 12% of GDP, and is forecast to remain at elevated levels for the foreseeable future. Even by 2014/15, net borrowing is forecast to be 4% of GDP, almost double the 2000/01 to 2008/09 average\(^9\).

Budget 2010 estimates that UK public sector net debt is forecast to peak at 74.9% of GDP (or £1.4 trillion) in 2014/15. This is more than double the net debt to GDP ratio in 2007/08\(^10\).

The need for fiscal consolidation has arisen as a result of a number of important factors – financing the fiscal stimulus, greater cyclical borrowing through the automatic stabilisers and a permanent loss in public sector revenue. Each of these elements is discussed below.

**Fiscal Stimulus**

In response to the global downturn, governments across the world responded with a series of discretionary initiatives to provide temporary support to economic activity. These stimulus programmes, by helping to offset falls in private sector output, helped ensure that the recession was shallower, and shorter, than would otherwise have been the case.

\(^10\) Net debt in 2007/08 as a share of GDP was 36.5% - Source: HM Treasury (2010) – Public Finances Databank, March 2010
In 2009, G20 countries implemented discretionary fiscal stimulus measures worth, on average, approximately 2% of GDP.

The UK discretionary stimulus in 2009 was estimated to have been in the region of approximately 1.6% of GDP. Key measures included the temporary reduction in VAT and a programme of accelerated capital spending.

### Table 1 – Fiscal Stimulus Packages in G7 Countries (% of GDP)

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canada</td>
<td>1.9</td>
<td>1.7</td>
</tr>
<tr>
<td>France</td>
<td>0.7</td>
<td>0.8</td>
</tr>
<tr>
<td>Germany</td>
<td>1.6</td>
<td>2</td>
</tr>
<tr>
<td>Italy</td>
<td>0.2</td>
<td>0.1</td>
</tr>
<tr>
<td>Japan</td>
<td>2.4</td>
<td>1.8</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>1.6</td>
<td>0</td>
</tr>
<tr>
<td>United States</td>
<td>2</td>
<td>1.8</td>
</tr>
<tr>
<td>G20</td>
<td>2</td>
<td>1.6</td>
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</table>


**Automatic Stabilisers**

During a downturn, falling demand creates excess spare capacity in the economy as resources are temporarily under-utilised. For example, firms typically operate at reduced levels of production in order to meet the lower level of demand.

The current recession has been no different and has led to a substantial drop in aggregate demand across all sectors of the economy.

This has been translated into a temporary increase in borrowing due to lower tax revenues and higher government expenditures. For example, income tax receipts have been lower, reflecting lower levels of economic activity while many welfare benefits have risen in light of increased unemployment.

**Permanent loss in public sector revenue**

Given the scale of the downturn, the actual stock of capital resources within the economy has been reduced, lowering the productive capacity of the economy relative to pre-recession levels. Such an effect feeds through to lower levels of output. The chart below highlights the Bank of England’s forecasts for the level of GDP in the UK with output not expected to return to its pre-recession level until late 2011\(^\text{11}\).

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This negative impact on the level of output, estimated to be just over 5%, has created a permanent hole in the public finances as a result of lower tax revenues and the projected rebalancing of economic activity\textsuperscript{12}.

A decline of this scale implies that, even after the economy has returned to its trend growth rate, future tax receipts will be permanently lower than if the financial crisis had not occurred. In the main, the need for fiscal consolidation stems from the action required to address these persistent effects.

Addressing the sustainability of the public finances will be an important challenge in the years ahead to ensure investor confidence in the economy and to maintain low interest rates.

**Planned Fiscal Consolidation**

Pre-Budget Report (PBR) 2008 announced a temporary suspension of the ‘Fiscal Rules’. These two rules, the ‘Sustainable Investment Rule’ and the ‘Golden Rule’ governed the fiscal framework in the UK over the last decade. In their place, a Fiscal Responsibility Act has been introduced\textsuperscript{13}. This framework, now enshrined in law, is intended to tightly constrain UK fiscal policy.

The Act establishes the following principal constraints that shape fiscal policy –

- Halve public sector net borrowing as a share of GDP over the four years to 2013/14 from its forecast peak in 2009/10;

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\textsuperscript{12} HM Treasury (2010) - Budget 2010 – page 21

\textsuperscript{13} HM Treasury (2010) – The Fiscal Responsibility Act
• Reduce borrowing as a share of GDP in each and every year from 2009/10 to 2015/16, and;
• Ensure that public sector net debt is falling as a share of GDP in 2015-16.

To achieve these objectives a number of measures to reduce public spending and increase tax revenues have been announced. Overall, between 2011/12 and 2014/15, the IFS estimate that the UK Government will implement fiscal tightening worth a cumulative 3.4% of GDP, as summarised in chart 5. Two thirds of this tightening is estimated to stem from reductions in spending with the remainder from taxation.

HM Treasury projections allow for a further fiscal consolidation worth 1.4% of GDP to be introduced between 2015/16 and 2016/17. The balance of this tightening toward revenue or expenditure has yet to be announced.

As a result of these measures, Budget 2010 forecast that public sector net borrowing will fall from 11.8% of GDP in 2009/10 to 4.0% of GDP in 2014/15, and that net debt will peak at 74.9% of GDP in that year. Illustrative projections contained within Budget 2010 suggest that net debt will fall to 70% of GDP by 2017/18 - chart 6.
The future strength of the UK public finances will depend on the outlook for cyclical and structural borrowing.

As the chart below highlights, under the projections published in the UK Budget 2010, cyclical borrowing as a share of GDP is currently forecast to gradually decline from a peak in 2010/11 through to 2014/15. The cyclically-adjusted current budget is forecast to return to balance by 2016/17. At the same time, the decline in structural borrowing reflects the plans for fiscal consolidation to reduce the element of the deficit that is more persistent.

It is important to note that both these projections are based upon HM Treasury forecasts for the UK economy which are currently more optimistic than the average of independent forecasts – table 2.

| Table 2 – GDP Growth Forecasts for the UK Economy (%) |
|---------------------------------|--------|--------|--------|
| International Monetary Fund (January 2010) | -4.8   | 1.3    | 2.7    |
| OECD (November 2009)                | -4.7   | 1.2    | 2.2    |
| Ernst & Young Item Club (November 2009) | -4.5   | 1.0    | 2.0    |
| Average of UK Independent Forecasts (March 2010) | -4.7   | 1.3    | 2.1    |
| Budget 2010 Forecasts (March 2010) | -5.0   | 1.0 – 1.5 | 3.0 – 3.5 |

To the extent that the actual path of the economy was to diverge from these forecasts then these projections for borrowing would be subject to change. If the economy was to recover more slowly cyclical borrowing would be expected to be

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14 HM Treasury (2010) – Budget 2010, Pg 32
15 The rate of GDP growth used in the public finance projections is a quarter of a percentage point below the centre of the forecast range published by HM Treasury (Budget 2010 Pg 198)
higher, while if there were a further loss in the productive capacity of the economy, structural borrowing may also rise. In both cases, in order to continue meeting the Fiscal Responsibility Act, a greater consolidation than is currently planned would have to be undertaken. This would have implications for the level of resources available to support public spending.
Section 2 – Future UK Public Spending

UK Public Spending Outlook

Under the current financial arrangements for funding the Scottish Government, the key driver of future changes to Scottish Government spending will be the pattern of spending changes at the UK level.

The following table, derived from tables C1 and C3 in Budget 2010, summarises the most recent HM Treasury projections for public spending in the UK.

| Table 3 - Planned Real Annual Growth in Aggregate UK Public Spending |
|-------------------|----------|----------|----------|----------|----------|
|                   | 2009/10 | 2010/11 | 2011/12 | 2012/13 | 2013/14 |
| TME               | 5.2%     | 2.2%     | -0.2%   | -0.1%   | -0.3%   | 0.4%     |
| Current Expenditure | 5.4%     | 4.2%     | 1.3%    | 0.5%    | 0.3%    | 0.4%     |
| Gross Investment  | 3.6%     | -15.6%   | -16.3%  | -8.2%   | -8.8%   | 1.6%     |

Source: Derived from tables C1 and C3 Budget 2010 (HM Treasury)

Budget 2010 forecasts that Total Managed Expenditure (TME) will be effectively frozen in real terms between 2011/12 and 2014/15. Therefore assuming that the economy grows in line with the path set out in Budget 2010, TME will fall from approximately 48.1% of GDP in 2010/11 to 42.4% of GDP in 2014/1516.

Current expenditure is forecast to increase over this period, though as will be discussed later, the vast majority of this increase will be in the form of increased debt interest payments and other expenditures associated with the economic downturn, such as unemployment benefits.

As a result, between 2011/12 and 2014/15, spending on UK AME is forecast to rise significantly. This implies that given TME is effectively frozen over the same period, UK DEL spending will be cut in real terms.

Capital spending is likely to bear a significant burden of the planned fiscal adjustment. Gross investment is scheduled to fall from 4.9% of GDP in 2009/10 to 2.6% of GDP in 2014/15. This represents an average annual real terms fall of 9.4% over the period\textsuperscript{17}.

\textsuperscript{17} HM Treasury (2010) – Budget 2010, Table C4
UK Public Spending - 2011/12 to 2014/15

Chart 8 - Estimated Real Growth in UK Aggregate Public Spending

The public accounts separate Total Public Expenditure (TME) into Annually Managed Expenditure (AME) and Departmental Expenditure Limits (DEL) –

- AME covers current and capital spending programmes which are not easily predictable and are not subject to firm multiyear limits. Key elements include debt interest payments and social transfers such as tax credits and unemployment benefit,
- DEL covers spending which is planned and controlled across the period of a spending review. It incorporates administrative budgets and all programme expenditures, such as health, education, housing and transport.

Projections for UK AME and DEL spending have yet to be published. To estimate them, the methodology applied in this report broadly follows the framework used by the Institute for Fiscal Studies (IFS)\(^\text{18}\). Annex A provides a description.

Chart 8 summarises the projections for public spending in the UK up to 2014/15.

Forecasts for AME spending over the period have been derived from a number of sources including: Budget 2010 Supplementary Material\(^\text{19}\) and forecasts from external analysts. These are outlined in Annex A. Over the period 2011/12 to 2014/15, UK AME is estimated to grow by an average 3.4% a year in real terms.

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\(^{18}\) Note: there are differences in calculation and sources between this report and the analysis of the IFS. Estimates will be different as a result.

\(^{19}\) HM Treasury (2010) – Budget 2010 the economy and public finances – supplementary material
From this a profile for total DEL spending, the difference between TME and AME, can be obtained. UK DEL is estimated to fall by an average 3.0% per annum in real terms between 2011/12 and 2014/15. This result is broadly consistent with previous forecasts by the IFS\(^\text{20}\).

Within DEL, capital spending is estimated to bear a relatively larger share of the burden. Between 2011/12 and 2014/15, capital DEL is estimated to fall by an average of 7.9% per annum in real terms with current DEL falling by an average of 2.1% per annum as illustrated in chart 9.

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\(^{20}\) IFS (2010) – Public services: the axe comes soon
Public Spending Beyond 2014/15

The public finance projections published in Budget 2010 cover the period to 2014/15. The Budget also contained illustrative projections up to 2019/20.

These projections are based on a further fiscal tightening worth 0.7% of GDP a year in 2015/16 and 2016/17. As this is cumulative, it means a combination of further spending cuts and/or tax rises worth 1.4% of GDP.

The composition of this tightening has yet to be announced. As an illustration, in the forecasts that follow, it is assumed that it is shared equally between revenue and public spending. An alternative scenario is provided in Section 6.21.

An adjustment of this form would provide sufficient, albeit limited, resources to allow UK TME to grow by approximately 1% on average in real terms during 2015/16 and 2016/17. As the effects of the economic recovery and stabilisation of public finances would serve to reduce the share that is required to support UK AME spending during these two years, the level of resource available for UK DEL would grow by an estimated 1.6% on average each year.

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21 Further details of the assumptions used in this section are set out in annex A.
Going further forward, under the current UK public finance projections, the planned fiscal consolidation will have been completed by the end of 2016/17. By this point the cyclically adjusted current budget is expected to return to balance (chart 10), and public spending and tax receipts are assumed to have returned to pre-recession levels, as a share of GDP – chart 11.

This will enable the growth in total UK spending (TME) to recover to rates associated with more benign times. If the growth of public spending were to match the growth in the wider economy, this would allow TME to grow in line with trend GDP at 2.5% per annum in real terms from 2017/18 onwards. Within this, however, UK DEL would be able to grow at a slightly faster rate of around 3% per annum, reflecting, a number of factors, including the benefits from a relative decline in debt interest repayments as a result of an improving fiscal position.

Charts 12 and 13 summarise these trends in UK TME, DEL and AME spending using the projections set out above and assuming that the economy recovered in the manner which HM Treasury predict.

The charts show that total UK public spending (TME) would be effectively frozen, in real terms, between 2010/11 and 2014/15 before a gradual adjustment to a long-term trend growth of 2.5%. Two further years of relative tightening in 2015/16 and 2016/17 will act to further constrain spending.

However, as outlined above, a number of important elements of AME spending are expected to grow significantly over this period. As a result, DEL spending is forecast to be subject to five years of tightening followed by two years of limited growth.
Given the significant effect that this seven years of adjustment will have on the level of public spending, even when growth returns to a more healthy state post 2016/17, it is forecast that UK DEL spending may not return to 2009/10 levels until approximately 2020/21.

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Chart 12 - Projected Path of UK TME

Source: HM Treasury Budget 2010 and Scottish Government calculations

Chart 13 - Projected Path of UK DEL and AME

Source: HM Treasury Budget 2010 and Scottish Government calculations
Section 3 - Scottish Government Spending

Scottish Government Spending

Under the current financial arrangements, the majority of Scottish Government spending is financed by the Scottish Block Grant which is determined in the main by operation of the Barnett Formula.

The Barnett Formula determines changes to the Block Grant for the Scottish Government, Welsh Assembly Government and Northern Ireland Executive. In essence, changes to the Block Grant are determined by increases or decreases in spending in Whitehall departments on programmes for which responsibility in Scotland is devolved.

The formula applies to Scottish Government Departmental Expenditure Limit (DEL) funding. It determines changes to the Scottish Block Grant, not the total level of the Block Grant.

The following factors determine the calculation made for each UK departmental programme in DEL which then underpins changes to Scottish Government DEL:
  o the quantity of the change in planned spending by Whitehall departments;
  o the extent to which the relevant Whitehall departmental programme is comparable with the services carried out in Scotland; and
  o Scotland’s population as a proportion of England, England and Wales or Great Britain as appropriate. The population projections used reflect the latest available mid-year estimates published by the Office for National Statistics (ONS).

Having determined the change within the Scottish Block Grant from one year to the next, it is then for the Scottish Parliament and Scottish Government to allocate spending within the Block Grant according to their own priorities. This includes the opportunity to supplement capital spending with resources from current DEL allocations but not vice versa.
Past Scottish Government DEL Expenditure

Since devolution, the Scottish Government DEL has experienced year on year real increases. Between 2000/01 and 2009/10, Scottish DEL expenditure grew by over 5% a year in real terms. Some of this growth reflects the transfer of responsibility from further devolution to Holyrood. Notwithstanding this, the growth in spending has been significant.

The current financial year in 2010/11 represents the first year since devolution where the DEL Budget that the Scottish Government has to spend is lower, in real terms, than in the previous year. Using the most recent GDP deflators, as published in the 2010 UK Budget, Scottish Government DEL expenditure will be 1.3% lower in 2010/11 than in 2009/10\(^2\).

\(^2\) Includes the effects of capital acceleration.
Section 4 – Impact of Future UK Public Spending Plans on Scottish Government Spending

UK Budget 2010 Scenario: Scottish Government Spending

Using estimates for total UK DEL expenditure derived from the UK Budget 2010, as outlined in Section 3, it is possible to obtain a corresponding estimate for Scottish Government DEL expenditure.

The exact impact of changes in total UK DEL on Scottish Government DEL depends upon how the aggregate UK spending adjustment is allocated across Whitehall departments, and the resulting consequentials allocated via the Barnett Formula.

As one illustration, Whitehall departments are assumed to receive the same nominal percentage changes in their current and capital budgets. The methodology applied in this section is set out in Annex B.

In this case, it is estimated that Scottish Government DEL expenditure would fall by approximately 2.9% a year in real terms over the period 2011/12 to 2014/15 - marginally lower than the comparable decline in total UK DEL. From the 2009/10 peak, this would imply a five year real-terms contraction in Scottish Government DEL expenditure of 2.6% per annum; that is a cumulative fall of 12.4%.

As a result, Scottish Government DEL expenditure would be £3.7 billion below its 2009/10 peak in real terms by 2014/15 – chart 15 and 16.

23 An alternative scenario, where certain elements of public spending are protected, is provided in Section 6.
As the charts illustrate, by 2012/13 the Scottish Government DEL would be broadly comparable with that in 2006/07, whilst by 2014/15 it would be comparable to that in 2005/06.

Consistent with the forecasts for the UK, Scottish Government capital DEL would incur a proportionately greater cut, with spending falling by £1.7 billion (42.8%) in real terms between 2009/10 and 2014/15. Current DEL is assumed to fall by £2 billion (7.9%), in real terms, over this same period.
Medium-term Outlook for Scottish Government Expenditure

Scottish Government Expenditure: Medium-term Outlook

The adjustment path for UK public spending after 2014/15, set out in Section 3, would only support modest real increases in Scottish Government DEL spending of 0.7% and 1.0% in 2015/16 and 2016/17 respectively. Once again, this assumes that each Whitehall department received the same percentage change in their cash budget each year.

From 2017/18, with the fiscal tightening complete, and public spending growing in line with the wider economy, Scottish Government DEL would be projected to grow by approximately 2.2% each year in real terms.

Whilst Scottish DEL spending is projected to start growing again in 2015/16, it is important to recognise that the level of public spending in Scotland would continue to remain below the 2009/10 peak for a considerable period of time.

As chart 18 highlights, assuming a consolidation period and subsequent adjustment path as set out in section 3, Scottish Government DEL spending would not be forecast to return to 2009/10 levels until 2022/23, a period of 13 years. The projections in chart 17 suggest that between 2009/10 and 2022/23, the relative Scottish Government spending foregone compared to an outturn in which it remained unchanged at its 2009/10 peak could be as much as £25 billion. One alternative way of interpreting this result is to view this as an average annual real terms reduction over this 13 year period of approximately £2 billion.
Chart 18 - Scottish Government DEL Expenditure (2010/11 Prices)

Source: Scottish Government calculations
Section 5 – Impact of Slower UK Economic Growth on the Public Finances

Alternative Scenario 1: Slower Recovery

A critical factor which will impact on the future outlook for both UK and Scottish public spending is the performance of the UK economy.

In contrast to the independent forecasts monitored by HM Treasury, Budget 2010 forecasts a relatively robust recovery from recession in 2011/12. In addition, the Budget assumed that the economy would grow above trend in each year from 2012/13 to 2014/15.

These forecasts underpin the current HM Treasury public finance projections set out above. If the economy did not grow as quickly as forecast, tax revenues would be lower and public spending higher than currently planned. This would require additional net borrowing were no further corrective action to be undertaken.

However, to comply with the Fiscal Responsibility Act, a sharper adjustment to other areas of expenditure and taxation would be necessary to ensure that public sector net borrowing is halved from its 2009/10 peak by 2013/14 and that net debt is falling as a share of GDP by 2015/16.

Impact of Slower Growth on Public Finances

Avenues through which slower growth will impact on Public Finances

Slower economic growth has a negative impact on the public finance targets through two sources. Firstly, by increasing the output gap it increases cyclical spending and reduces cyclical tax receipts24. Secondly, it reduces the level of GDP in future years.

24 There is a third avenue– greater structural borrowing. This has the potential to have the most damaging impact on the public finances requiring an even greater consolidation. However, for the purposes of this analysis it is assumed that there is no additional structural loss in output but rather a longer return to trend, and therefore only greater cyclical borrowing.
This increases the public sector’s borrowing requirements relative to the size of the economy and makes achieving those targets which are expressed as relative share of GDP more difficult.

**Estimated impact on UK total expenditure and revenue**

As an illustrative example, the following section considers the impact on the public finances if the economy recovered at a slower rate than that which underpins the Budget 2010 public finance forecasts. This is consistent with the views of many independent commentators who expect the economic recovery to be more gradual.

The scenario in chart 19 reduces the growth assumption for both 2010/11 and 2011/12 by 1 percentage point and in 2012/13 by ¼ of a percentage point.

Using a series of Ready Reckoners which estimate the impact of changes in the economy on the public finances, it is possible to estimate the additional cyclical spending and fall in tax receipts which may be generated under the growth forecast in chart 18.

Under this scenario, in cash terms, UK tax receipts would be £6.2 billion a year lower, in real terms, on average, between 2010/11 and 2017/18, whilst UK TME would be, on average, £16.2 billion a year higher, compared to the scenario presented in section 4.

Approximately 20% of the increase in TME is estimated to come from higher Social Security spending, with the remainder from higher debt interest payments and increases in other spending.

The impact of this additional spending and lower receipts on the overall fiscal position is summarised in charts 20 and 21. Without any further corrective action, this scenario would result in greater UK net borrowing each year and UK net debt rising to over 80% of GDP.

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25 HM Treasury (2008) – Public Finances and the Cycle
In such an eventuality, additional fiscal tightening would be required to ensure that the targets set out in the Fiscal Responsibility Act were met. The composition and timing of such tightening would present a trade-off between supporting recovery and stabilising the public finances.

**Impact of Slower Growth: Illustrative Outlook for Scottish Government DEL Expenditure**

Chart 22 sets out an example of additional fiscal tightening under the slower growth scenario set out above which would be sufficient to ensure that, consistent with the Fiscal Responsibility Act, net borrowing was cut in half by 2013/14 and net debt started to fall from 2015/16 onwards.

The impact to the resources available to the Scottish Government would depend upon the nature of any such additional tightening and the balance between higher taxes and lower public spending. In the illustration below, all additional tightening is set to come from current DEL, based on the fact that it is primarily spending increases which account for the deterioration in the public finances observed in charts 20 and 21. Other alternative illustrations are possible, but would do little to alter the basic point.

Charts 23 and 24 illustrate the evolution of the Scottish Government DEL under such a scenario. The results from the Budget 2010 scenario in Section 4 are included for reference. All assumption and estimation techniques, except the growth rate in the economy, remain as before.
The impact of the slower recovery and resulting relative deterioration in the public finances can be clearly observed. In this scenario, Scottish Government DEL spending would fall by 2.3% a year in real terms over the seven years 2010/11 to 2016/17 (a cumulative fall of 15.0%). This compares to a 1.6% average annual fall in the scenario set out in Section 4. Moreover, as the scale of the cuts would be larger, the adjustment path to restoring the level of public spending at pre-recession levels would be elongated. Under this slow growth scenario, Scottish Government DEL would not return to 2009/10 levels until 2024/25.

The real terms projections in chart 24 suggest that between 2009/10 and 2024/25, the relative DEL expenditure foregone compared to an outturn in which expenditure remained unchanged at its 2009/10 peak could be as large as £35 billion. One alternative way of interpreting this result is to view this as an average real terms reduction each year over this full 15 year period of approximately £2.3 billion.
Section 6 – Further Alternative Scenarios

Alternative Scenario 2: Protecting Frontline Services

As outlined above, under the current financial arrangements, changes in total Scottish Government DEL expenditure are determined by increases or decreases in spending in Whitehall departments.

The ‘consequentials’ that Scotland receives depends critically on the extent to which the relevant Whitehall departmental programme is comparable with the services carried out in Scotland.

If cuts (or increases) were concentrated in Whitehall departments such as Health, where responsibility in Scotland is almost entirely devolved, these changes would have a relatively large impact on the Scottish Government DEL. Conversely, if cuts (or increases) were concentrated in Whitehall departments where policy responsibility is largely, or entirely, reserved, such as the Department for Work and Pensions, Defence, or the Foreign and Commonwealth Office, the impact on total Scottish Government spending would be more modest.

As an illustration of how changes to the relative burden of adjustment from within Whitehall departments could impact on Scottish Government spending, an additional scenario is considered below.

Whilst the current UK Government has yet to announce detailed departmental spending allocations beyond 2010/11, a number of, as yet un-costed, commitments have been set out for the years 2011/12 and 2012/13\(^{26}\). These include –

- NHS front-line spending to rise in line with inflation;
- Spending on front-line schools to rise by 0.7% a year in real terms;
- Spending on 16 to 19 year old participation in education to rise by 0.9% a year in real terms;
- Near-cash spending on Sure Start Children’s Centres to rise in line with inflation. Spending on Overseas Aid to reach 0.7% of Gross National Income by 2013;

\(^{26}\) HM Treasury (2009) – Pre Budget Report 2009, Pg 1
• Funding to be provided to “police authorities to enable them to maintain police and community support officer numbers”.  

Based on published budget figures for Health, Education and Overseas Aid, it is possible to estimate the resources that might be required to meet these objectives.

Chart 25 illustrates the potential impact on Scottish Government DEL expenditure of fulfilling such commitments, if the burden of adjustment required to meet these obligations were shared equally across all other Whitehall departments, and the non-protected areas of Health and Education. As these commitments only apply to the years 2011/12 and 2012/13, for the purposes of this illustration, in the subsequent two years it is assumed that all Whitehall departments receive the same percentage reduction in their cash budgets.

Under this scenario, Scottish DEL expenditure from 2012/13 onwards would be approximately £300 million (1%) higher in real terms per annum than under the UK Budget 2010 scenario set out in Section 4 where such elements of spending were under no such protection. Nevertheless, even in such a scenario, Scottish Government spending would still be subject to a period of significant and sustained cuts. For example, assuming that the path of adjustment post 2017/18 followed that set out in section 4, even in this case of protected spending the total adjustment period until the previous peak of 2009/10 was restored in real terms would last 12 years, until 2021/22, as illustrated in chart 26. Over this period the relative DEL expenditure foregone compared to an outturn in which expenditure remained unchanged at 2009/10 levels would be £22 billion. This is equivalent to an average real terms reduction each year over this full 12 year period of approximately £1.8 billion.

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28 The information required to estimate the potential cost of achieving the commitment on police numbers is not publically available. Therefore the effect that this commitment could have on Scottish Government expenditure is not considered in this section.
Of course, were the required additional cuts in other Whitehall budgets concentrated in areas where the Barnett consequentials are large, then Scottish DEL expenditure would be subject to less protection.
Alternative Scenario 3: Composition of Fiscal Tightening in 2015/16 and 2016/17

As discussed above, the current balance of consolidation up to 2014/15 is two thirds spending and one third taxation.

In the analysis contained in Section 3 and Section 4, as the details have yet to be announced, the additional UK fiscal tightening proposed for 2015/16 and 2016/17 was split 50:50 between revenue and taxation. If this burden were to be skewed toward either taxation or revenue, then this would have implications for Scottish Government spending.

As an illustration of this, the charts below highlight the impact on the Scottish DEL if two thirds of the additional tightening planned for 2015/16 and 2016/17 stemmed from lower public spending, with only one third from higher taxation. This would mean that in 2016/17, UK TME would stand at 40.9% of GDP under this scenario, compared to 41.1% of GDP under the scenario in Section 4. As above, the results from Section 4 are included for comparison.

The results show that changing the composition of tightening in 2015/16 and 2016/17 would not have a significant impact on the projected path of public spending in Scotland. But the effect would be more severe than if the additional consolidation burden was shared equally between taxation and public spending. Under this scenario, Scottish Government DEL expenditure would fall by an average 1.8% each year in real terms between 2010/11 and 2016/17 compared to an average fall of 1.6% a year in the scenario in Section 4. Therefore, under this scenario, there would be a cumulative decline of 11.7% between 2009/10 and 2016/17, compared to 10.9% under the UK Budget 2010 scenario.

This small additional burden of consolidation reflects the effects of skewing the fiscal tightening in these two years toward spending as oppose to revenue.

Such a decline and subsequent adjustment path would still lead to Scottish Government DEL returning to its 2009/10 level in 2022/23. Over this period the relative DEL real terms expenditure foregone compared to an outturn in which expenditure remained unchanged at 2009/10 levels would be £27 billion. One alternative way of interpreting this result is to view this as an average real terms reduction each year over this full 13 year period of approximately £2.1 billion.
Chart 28 - Real Growth in the Scottish Government DEL Expenditure

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<thead>
<tr>
<th>Year</th>
<th>% Real Annual Change</th>
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<tr>
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</tr>
<tr>
<td>2010/11</td>
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<tr>
<td>2020/21</td>
<td>3%</td>
</tr>
<tr>
<td>2021/22</td>
<td>4%</td>
</tr>
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</table>

Source: Scottish Government calculations

Chart 29 - Scottish Government DEL Expenditure (2010/11 Prices)

<table>
<thead>
<tr>
<th>Year</th>
<th>£ Millions (2010/11 Prices)</th>
</tr>
</thead>
<tbody>
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</tr>
<tr>
<td>2014/15</td>
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</tr>
<tr>
<td>2015/16</td>
<td>27 Billion</td>
</tr>
<tr>
<td>2016/17</td>
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<td>2017/18</td>
<td>27 Billion</td>
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<tr>
<td>2018/19</td>
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<tr>
<td>2019/20</td>
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</tr>
<tr>
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</tr>
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<td>27 Billion</td>
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<tr>
<td>2022/23</td>
<td>27 Billion</td>
</tr>
</tbody>
</table>

Source: Scottish Government calculations
Conclusions

- The recession and financial crisis have led to a significant deterioration in the UK’s fiscal accounts.

- To reduce public sector borrowing the UK Government are planning for a combination of tax rises and spending cuts to be enacted over the next few years.

- While precise details remain uncertain, an initial assessment suggests that the Scottish Government DEL may experience five consecutive years of real-terms cuts and it may take a further two years before growth returns to trend.

- While the exact magnitudes are as yet unclear, this report concludes –
  - reductions averaging approximately 3% a year in real terms between 2011/12 and 2014/15 are likely;
  - by 2014/15, the Scottish DEL could be between £3½ and £4 billion lower in real terms than in 2009/10;
  - it will take a period of sustained adjustment lasting up to 12 to 15 years before 2009/10 levels of expenditure are reached once again in real terms; and
  - over this period, Scottish expenditure could cumulatively forego between £25 and £35 billion compared to a situation whereby the 2009/10 peak level of DEL remained unchanged.

Overall Outlook

As a consequence of the financial crisis and the subsequent global recession, there has been a significant and rapid deterioration in the UK’s fiscal accounts.

To address this, a fiscal adjustment has been identified which is now enshrined in law through the Fiscal Responsibility Act. This sets out a relatively constraining and rigid adjustment for the stock of UK debt and the flow of annual net borrowing.
With the current taxation regime and the assumptions for the recovery of the economy, this provides a picture of the burden of adjustment that is now placed on total UK expenditure (TME). With AME growing rapidly at present, UK DEL spending – the principal determinant of spending on public services—must contract significantly over the medium term. Given the scale of this adjustment, and even allowing for a period of sustained trend growth, UK DEL spending is likely to remain below its pre-recession levels for a considerable period of time.

**Scottish Expenditure (DEL) Outlook**

The UK outlook has important implications for the profile of Scottish DEL expenditure over the medium to long term.

While the UK Budget 2010 provides little insight into the precise evolution of Scottish expenditure, an understanding of these expenditure trends is critical to allow the planning and prioritisation of expenditure over the medium to long term to be effectively conducted.

Given the lack of specific UK data, this work seeks to provide some insight into these future Scottish expenditure (DEL) trends. In this regard, the paper concludes –

- Scottish expenditure is likely to experience five consecutive years of real-terms cuts and it may take a further two years before growth returns to trend;
- reductions averaging approximately 3% a year in real terms between 2011/12 and 2014/15 are likely;
- by 2014/15, the Scottish DEL could be between £3½ and £4 billion lower in real terms than in 2009/10;
- it will take a period of sustained adjustment lasting up to 12 to 15 years before 2009/10 levels of expenditure are reached once again in real terms; and
- over this period, Scottish expenditure could cumulatively forego between £25 and £35 billion compared to a situation whereby the 2009/10 peak level of DEL remained unchanged. The upper end of this scale is more likely if the UK economic recovery was to be slower than forecast in Budget 2010.

While these figures represent an illustration of a possible future path for public spending in Scotland, the outcome may differ from these initial projections. However, given the overall trend in the public finances, public spending and the economy, it is clear that the level of resources available to the Scottish Government to fund public services in Scotland will be subject to significant constraints in the years ahead. This will present a significant challenge for the delivery of public services in Scotland.
Annex A – Methodology to Estimate Future UK Public Spending

UK Public Spending between 2011/12 and 2014/15

TME
- Calculated as the sum of current expenditure and gross investment, as reported in the 2010 UK Budget.

AME
- Gross debt interest payments: Difference between the primary budget and current budget balance (net debt interest) plus general government interest and dividends received. Source HM Treasury (2010) - Budget 2010 and Budget 2010 the economy and public finances – supplementary material
- Social Security expenditure: Assumed to grow by 1.1% a year in real terms as estimated by the IFS.29
- Other AME – Assumed to grow on average by 3.1% a year in real terms. Consistent with unpublished HM Treasury documents reported in the media in September 2009.

DEL
- Calculated as the difference between TME and AME.
- Capital DEL - Assumed to change in line with projections for total public sector gross investment reported in Budget 2010.
- DEL Depreciation – Assumed to remain fixed as a share of total depreciation (AME & DEL) from 2011/12 onwards.
- Current DEL – Calculated as total DEL minus capital DEL and depreciation.

Reference Variables
- Values of Money GDP and the GDP deflators are taken from table C1 of the UK Budget 2010.

UK Public Spending in 2015/16 and 2016/17

TME
- Assumed to move from 42.4% to 41.1% of GDP between 2014/15 and 2016/17. Based on the premise that 50% of the fiscal tightening to be implemented in these years is in the form of spending cuts and that there is an additional cyclical improvement in the public finances.

AME
- Gross debt interest payments - assumed to grow in line with the stock of outstanding government debt.

29 IFS (2010) – Public services: the axe comes soon
Social security expenditure - assumed to grow in line with GDP deflators. This results in social protection falling from 10.7% of GDP in 2014/15 to 10.2% of GDP by 2016/17.

Other AME – Assumed to grow by 1.9% a year in real terms – the average increase for these elements of AME forecast in the 2007 Comprehensive Spending Review for the period 2008/09 to 2010/11.\(^\text{30}\)

**DEL**
- Total DEL is calculated as the difference between TME and AME.
- Capital DEL - Assumed to remain fixed as a share of GDP (consistent with path for gross investment announced in Budget 2010).\(^\text{31}\)
- DEL Depreciation – Assumed to remain fixed at its current level as a share of GDP.
- Current DEL – Calculated at total DEL minus capital DEL and depreciation.

**Reference Variables**
- GDP and GDP deflators are assumed to grow by 2.5% a year in real terms and 2.75% a year respectively (consistent with HM Treasury’s long-term projections).

**UK Public Spending from 2017/18 Onwards**
- All key aggregate variables assumed to remain constant as a share of GDP, growing at 2.5% a year in real terms, from 2018/19 onwards with exception of debt interest repayments which are forecast to fall in line with the projected reduction in public sector net debt and ‘other AME’ which is assumed to grow by 1.9% a year in real terms – the average increase for these elements of AME forecast in the 2007 Comprehensive Spending Review for the period 2008/09 to 2010/11.
- Real GDP assumed to grow at 2.5% per annum. GDP Deflators assumed to increase by 2.75% per annum.
Annex B – Methodology to Estimate Future Scottish DEL Expenditure

Scottish Government DEL Expenditure between 2011/12 and 2014/15

- Each Whitehall department is subject to capital DEL reductions averaging 5.7% a year in cash terms (7.9% a year cut in real terms) between 2011/12 and 2014/15.
- Each Whitehall department is subjected to current DEL increases averaging 0.2% a year in cash terms (2.1% a year cut in real terms) between 2011/12 and 2014/15.
- Scotland receives the resulting consequentials through the Barnett formula.

Scottish Government DEL Expenditure after 2014/15

- Each Whitehall department is subject to capital DEL increases averaging 5.3% a year in cash terms (2.5% a year increase in real terms) in 2015/16 and 2016/17.
- Each Whitehall department is subjected to current DEL increases averaging 4.3% a year in cash terms (1.5% a year increase in real terms) between 2015/16 and 2016/17.
- For 2017/18 and beyond, each Whitehall department is assumed to receive the same nominal percentage increase in current and capital DEL expenditure, consistent with holding TME constant as a share of GDP.
- Scotland receives the resulting consequentials through the Barnett Formula.