

## FINANCE COMMITTEE

### DRAFT BUDGET 2009-10

#### Pre-Budget Report 2008: Effects on Scottish Government Budget

Paper by Professor David Bell, Budget Adviser to the Finance Committee

##### **1. Barnett Consequentials**

The effect of the changes announced in the 2008 PBR on Scotland's DEL resource allocation coming through Barnett consequentials will not be significant. This is because the changes in departmental DEL allocations for 2009-10 and 2010-11 are generally small. The only minor exception is the Department for Work and Pensions, whose budget will increase by £0.8bn, but this is unlikely to have any effect on the Scottish Government budget, since pensions and social security are reserved to Westminster. The Scottish Government has issued a press release which states that Barnett consequentials will only amount to £11m.

The effects on capital budgets are more significant. A large amount of capital spending – Transport (£0.7bn), Innovation, Universities and Skills (£0.5bn) and Local Government (£1.5bn) – has been brought forward from 2010-11 into 2008-09 and 2009-10. Changes in the profile of capital spending by these Westminster departments will allow the Scottish Government to reprofile £260m of capital spend. This is discussed below. However, there is also a reduction in the Department of Health's capital budget of £1.4bn in 2010-11. This is not a reprofiling and will mean a recurring reduction of around £125m in the Scottish Government capital budget. This cut in the capital budget is due to the effects of Barnett consequentials on the Scottish Government budget.

##### **2. Reprofiting of Capital Spend**

The Scottish Government will be able to reprofile £260m of capital spend, bringing it forward from 2010-11 to 2008-09 and 2009-10. There is no net change in the cash available to the Scottish Government. It is worth noting that, unlike most post-war recessions, there is a possibility that prices will fall during at least part of the period to 2010-2011. This could mean that the real value of the cash spend might be greater in

2010-11 than in 2009-10. Capital reprofiling will again increase pressure on the 2010-11 budget.

Moving spending forward would affect Scotland's "baseline" in future Spending Reviews since the year selected for the baseline is most likely to be the most recent for which data is available. If spending is unusually low in that year, then future allocations may be adversely affected.

If the decision is taken to move capital spend forward into 2008-09 and 2010-11, then there is clearly a requirement to ensure that projects are designed, financed and built in a timely manner.

### **3. Efficiency Savings**

The 2010-11 resource DEL includes a non-specific £5bn of "Additional Value for Money Savings". These have also been referred to as "Efficiency Savings" and, in Scotland, come on top of the 2 per cent annual efficiency savings already built into the budget. If these savings are shared equally across DEL budgets, then the Scottish Government's budget would fall by £380m (1.4 per cent). Thus, the net increase in productivity or real reduction in costs required to maintain Scottish public service provision at their 2009-10 level during 2008-09 would be around 3.4 per cent. Clearly, this will be a testing target.

Note that the savings required will be greater if the allocation of savings to Westminster departments is weighted towards those where the Scottish Government has comparable programmes, such as Health and Education. On the other hand, when UK government spending is falling, the Barnett Formula in theory protects Scottish spending. This is because the Barnett "Squeeze" goes into reverse. Scotland will be allocated its population share of any cuts which are made, rather than its actual share, which is somewhat higher.

### **4. End-Year Flexibility**

As agreed with the Treasury, £400m of End Year Flexibility (EYF) monies are being drawn down in 2009-10 followed by £174m in 2010-11. An additional £42m of EYF was accumulated in 2007-08 and there may be further underspend in 2008-09, though this is not likely to be significant. The 2008 PBR gives assurance that the facility to draw down EYF monies

will continue to be available to the Scottish Government in 2010-11. However, this facility is being made available to offset the Barnett consequential effects of a reduction in the Department of Health's capital budget of £1.3bn in 2010-11. However, EYF is simply a mechanism to reprofile Scotland's allocation from Westminster. The Department of Health capital budget reduction is a net reduction in that budget.

## **GDP Deflator**

The GDP deflators for 2008-09 to 2010-11 have changed as a result of the change in economic conditions and the decisions taken in the PBR. These are shown below.

GDP Deflators CSR 2007 and PBR 2008

	2008-09	2009-10	2010-11
2007 Comprehensive Pending Review	2.75	2.75	2.75
2008 Pre-Budget Report	3.25	1.5	2.75
Difference	+0.5	-1.25	0

The path of the deflators is explained by the higher than expected inflation during 2008-09, a fall during 2009-10, which is partly precipitated by the reduction in VAT, and a return to trend in 2010-11. This would seem to be contingent on a recovery during the latter part of 2009, which as yet, is very uncertain. There must be a distinct possibility that the rate of price inflation will fall below 2.75 per cent, even if VAT is restored to 17.5 per cent.

These alterations to the GDP deflator will have implications for real rates of growth in Scottish Government expenditure during 2008-09, 2009-10 and 2010-11. They also have implications for how easy or difficult it may be for public bodies to achieve their efficiency savings targets. Finally, if the GDP deflator is as high as 2.75 per cent, then coupled with the "value for money savings", the Barnett consequentials and capital reprofiling, there will be a possibility that real public spending in Scotland will fall during 2010-11 for the first time since the early 1990s.

**David Bell**

