Cuthbert, Jim and Cuthbert, Margaret (2007) How Scotland will be disadvantaged in the longer term by recent changes in government accounting for European structural funds. Quarterly Economic Commentary, 31 (4). pp. 41-48. ISSN 0306-7866 ,

This version is available at https://strathprints.strath.ac.uk/46905/

Strathprints is designed to allow users to access the research output of the University of Strathclyde. Unless otherwise explicitly stated on the manuscript, Copyright © and Moral Rights for the papers on this site are retained by the individual authors and/or other copyright owners. Please check the manuscript for details of any other licences that may have been applied. You may not engage in further distribution of the material for any profitmaking activities or any commercial gain. You may freely distribute both the url (https://strathprints.strath.ac.uk/) and the content of this paper for research or private study, educational, or not-for-profit purposes without prior permission or charge.

Any correspondence concerning this service should be sent to the Strathprints administrator: strathprints@strath.ac.uk
How Scotland will be disadvantaged in the longer term by recent changes in government accounting for European structural funds

Jim Cuthbert
Margaret Cuthbert

1. Introduction

1.1 In 2006, the Treasury reclassified the way in which receipts from the EU are handled in the UK government's public expenditure control system. This was intended to be a purely technical change, whose impact would be budgetarily neutral. We show here that, as regards Scotland, this will not be the case. Both the Treasury and the Scottish Executive have failed to accommodate the fact that receipts from European structural funding in Scotland have always been handled in an anomalous fashion. The interaction of the reclassification with the way in which EU receipts were handled in Scotland, combined with the planned reduction in Scotland's allocation of structural funds in the 2007-2013 round, means that Scotland will be materially disadvantaged financially in the longer term.

1.2 The primary purpose of this note is to explain in detail how this paradoxical situation has come about, and how Scotland will be disadvantaged. The secondary purpose, however, is to argue that it is now time for the Government to provide detailed, verifiable data, on how much additional public expenditure cover for structural fund receipts Scotland did actually receive in the past. Until this is done, the effects identified in this paper cannot be properly quantified: and without proper quantification, they cannot be rectified.

2. Background

2.1 This section of the paper sets out essential background on how EU receipts are handled in the UK government's public expenditure control system. Specifically, this section covers:

a) the need for public expenditure cover for expenditure funded by EU receipts;

b) how the Scottish Office, (and latterly, the Scottish Executive), differed from most other government departments in the way it was allocated public expenditure cover for expenditure funded by EU receipts;

c) the EC legal requirement for countries to be able to demonstrate additionality for expenditure funded by EU receipts;

d) the change to the system in the UK for accounting for EU receipts introduced by the Treasury in 2006.

What the change at (d) means is that, as from 2006, receipts from the EU are counted as negative entries against a Department's expenditure control total, (that is, its Departmental Expenditure Limit, or DEL). Unfortunately, before the significance of this change can be appreciated, it is necessary to go through the other technicalities described in this background section.

The need for public expenditure cover for expenditure funded by EU receipts: the situation prior to 2006

2.2 This paper is primarily concerned with European Structural Funds, which comprise the European Regional Development Fund, (ERDF), the European Social Fund, and some smaller programmes. Structural funds are allocated by the EC to certain programmes, which are in themselves often area specific. For example, the Highlands and Islands qualified for Objective 1 assistance under the ERDF in 1994. When EU receipts were spent on a structural fund project, then that expenditure also counted as public expenditure against the appropriate UK public expenditure programme: for example, when ERDF funds were spent on an Objective 1 project in the Highlands and Islands, then that expenditure counted as expenditure in the public expenditure programme of the Secretary of State for Scotland, (prior to 1999), or of the Scottish Executive thereafter. (Note that ERDF funded expenditure would also normally need to attract an equivalent amount of matched funding. The question of matched funding raises further issues - but we are not primarily concerned with these in this paper.)

It is important to note that expenditure funded from structural fund receipts counted, (or scored, in public expenditure terms), against the Departmental Expenditure Limit (DEL) of the responsible department. The DEL is effectively that part of a department's expenditure which is cash limited. The department therefore had to have, within its DEL, adequate public expenditure cover for anticipated structural fund expenditure.

This then raises the question of whether, for a given department, the public expenditure cover within its DEL for European funded expenditure was additional to what the DEL would have been if there had been no EU funding; or
whether the required public expenditure cover had been carved out, (in whole or in part), from the pre-existing DEL. For a conventional Whitehall department, the answer to this question is likely to be straightforward: namely, that the public expenditure cover within its DEL for EU funding would indeed be additional to what the DEL would otherwise have been. This is because, for such a department, public expenditure planning is done on an incremental basis: with the department having the opportunity to bid, at the time of the Comprehensive Spending Review, for the extra public expenditure resources required to cover an eventuality like an increased allocation of structural funds.

**Public expenditure cover for structural fund expenditure in Scotland**

2.3 The situation in Scotland, however, has been different. Changes to the DEL of the Scottish Executive, (and, formerly, the Scottish Office), are determined solely by the operation of the Barnett formula. Formally, the Scottish Assigned Budget, (formerly the Scottish Block), is adjusted on a per capita basis for changes in the corresponding English programmes. So, prior to 2006, changes to the Scottish DEL in relation to the EU structural funds arose, not in relation to the amount of EU structural funds allocated to Scotland, but in relation to the Barnett consequences of structural funds allocated to England.

The fact that the public expenditure cover for structural fund expenditure within the responsibility of the Secretary of State for Scotland was handled entirely by the normal Block, (i.e., Barnett) arrangements, is made clear in the following House of Commons exchange:

**Mr Swinney:** To ask the Secretary of State for Scotland what proportion of the structural funds in each year since 1974 were (a) allocated for cover to the Scottish Office DEL and its previous equivalents through the Scottish Block arrangement; and (b) applied using specially negotiated agreements.....

**Mr Macdonald:** Public expenditure provision for all European Regional Development Fund or Social Fund expenditure for which the Scottish Office was responsible in the period since 1974 has been within the Scottish Office DEL and its previous equivalents. There have been no "specially negotiated agreements" covering the application for European Regional Development Fund or European Social Fund receipts.


2.4 In fact, it appears unlikely that the way in which EU structural funds impacted on the Scottish DEL would be quite as straightforward as implied by the above parliamentary exchange. For example, prior to 1992, the Scottish programme for industry, energy, trade and employment (excluding tourism), was a separate programme within the Secretary of State’s responsibility, and did not form part of the Block, that is was not subject to the Barnett formula: (ref: Scottish Office, 1993). Further, in the period during the run-up to the negotiation of the UK rebate in 1985, part of the interim rebate arrangements for the UK involved the determination of special allocations of the rebate for specific regions/countries within the UK. (HM Treasury, 1981). How these special allocations interacted with the Barnett mechanism is unclear.

2.5 The question then arises of how much public expenditure cover was actually added to the Scottish Block as a result of European structural fund allocations: and how did this relate to the size of European structural fund allocations to Scotland? In principle, it is perfectly possible that at any given point in time, the sum of the successive increments given to Scotland through the operation of the Barnett formula on structural fund allocations to England could be significantly different from the actual allocation of structural funds to Scotland at that time. In fact, given that Scotland’s early structural fund allocations were proportionately large compared to England’s, it is likely that Scotland may well have received only a fraction of its structural fund allocation by way of additional public expenditure cover in its DEL.

It appears that no figures have ever been published on this by the government: nor does the available published information allow outsiders to recreate the appropriate calculations, particularly in the light of the complicating factors identified in the previous paragraph. We do, however, come back to this question in section 3, where we make some, avowedly crude, estimates based on published information.

2.6 The European Committee of the Scottish Parliament carried out an inquiry into European Structural Funds and their implementation in Scotland in 2000. Among the questions they considered was how much additional public expenditure cover had actually been allocated to the Scottish DEL in respect of Structural Funds: (European Committee, 2000). One of the major sources of evidence the Committee examined on this topic was a paper by Bell and Christie (2000). This paper discussed the implications of the Barnett formula and its interaction with ERDF funding: in it, Bell and Christie state that:

“If the change that Scotland receives in its ERDF allocation from the EU is greater than that received by England, then there will be a shortfall in funding. However, if ERDF provision in Scotland is growing more slowly than it is in England (which certainly occurred during the 1994-95 programming period), then there will be no shortfall.”

This statement, however, could mislead. While the mechanism Bell and Christie describe refers to changes in allocations and public expenditure provision, their conclusion “there will be no shortfall” is drafted in such a way that it could be interpreted as referring to absolute levels. It is true to say that, if ERDF provision in Scotland is
growing more slowly than that in England, then the change in public expenditure provision in the Scottish DEL resulting from the Barnett consequence of the change in the English allocation will exceed the change in the Scottish allocation. However, if the Scottish public expenditure provision were starting from a position of shortfall relative to the Scottish structural fund allocation, then the greater increase in the period in question might be very far from wiping out the entire deficit, and Scotland might well end the period still suffering from an absolute deficit in public expenditure provision.

2.7 In the light of this, the Committee’s conclusion as to whether there was indeed adequate additional public expenditure cover appears unduly reassuring. Consider the following: “The Committee considers that, over the 2000-06 period, it is unlikely that Scotland is losing out in the allocation for Structural Funds in the Assigned Budget given that Structural Fund expenditure in Scotland is planned to increase (compared to the 1994-99 period) at a slower rate than in England, and the Barnett formula is likely to deliver to Scotland more resources. Indeed, the Committee has been assured that the Assigned Budget contains a surplus in provision for Structural Funds over the next seven years.” (European Committee, 2000). The first sentence in this quotation clearly relies heavily on the Bell and Christie paper, and is therefore subject to the criticism outlined in the previous paragraph. The last sentence in this quotation is irrelevant, since the real issue is not how much provision has been earmarked for structural funds cover within the Assigned Budget, but how much of this represents genuinely additional provision.

2.8 The clarity of public debate on this issue in Scotland has not been helped by some confusing statements by the Executive. For example, the following statement was made by Jack McConnell when he was Finance Minister. “Structural funds are additional to other expenditure in the Scottish Ministers’ Assigned Budget, but they are also an integral part of it.” (ref: Evidence to European Committee of Scottish Parliament, 30th May 2000).

2.9 The fact that Scotland could well have received only a fraction of its structural fund allocation by way of additional public expenditure cover in its DEL has excited relatively little public interest in Scotland. This contrasts with the position in Wales. When much of Wales achieved Objective 1 status in 2000, it rapidly became clear to the Welsh Assembly and public that little or no financial advantage to Wales would result, and there would also be considerable internal dislocation of spending programmes, due to the need to accommodate public expenditure cover and matched funding within a virtually unchanged DEL. After mounting a vigorous campaign the Welsh successfully obtained an exception to Barnett, which gave them an additional £272m in their DEL, to at least partially alleviate the identified problems; (ref: European Committee, 2000).

Additionality

2.10 It is also appropriate to consider the legal requirement on structural fund recipients to demonstrate additionality. There is a discussion of this issue in the Scotland Office minute of evidence to the House of Commons Scottish Affairs Committee in 1999. The basic requirement, set out in Article 11 of Regulation 1260/99 is that:

“In order to achieve a genuine economic impact, the appropriations of the funds may not replace public or equivalent structural expenditure by the Member States.”

Rules on the implementation of the additionality requirement had been set out in the Kerr-Millan agreement of 1992, and have been refined subsequently. Basically, additionality has to be demonstrated at the level of the relevant Objective 1, (or if appropriate, Objective 2 and 3) area. The important point, from a Scotland point of view, is that there is no requirement to demonstrate additionality at the levels of regions/countries within Member States: (Scotland Office, 1999).

2.11 The European Committee of the Scottish Parliament expressed their dissatisfaction with this state of affairs, as follows:

“However, the Committee believes that, in the ‘spirit of additionality’, it should be possible to demonstrate the degree to which Structural Funds are additional to domestic spending in Scotland. Although the Funds are certainly additional for individual project applicants, at the Scotland level the published figures are inadequate for determining the net impact of EU funding on overall Departmental and programme economic development spending.

Although requests were made to UK Government Ministers to attend the Committee’s Inquiry meetings, they declined. The Committee feels that the subsequent written information provided was not sufficient to verify the net impact of EU funding on economic development spending in Scotland. This is a matter of regret.”

(European Committee, 2000)

The change in the treatment of European funding in 2006

2.11 With effect from 2006-07, the Treasury has reclassified receipts from the European Union as negative DEL: (Scottish Executive, 2006). The result of this reclassification is that the budget for structural fund expenditure is now reported net of expected EC receipts. As the structural fund programme is fully funded by the EC, this means that payments out of the budget on structural fund projects are exactly balanced by payments in from the EC - so net expenditure on the structural fund budget is now zero. With effect from the 2006-07 planning round,
therefore, the Scottish Executive DEL has been reduced to allow for this change.

What this change means, effectively, is that expenditure on structural fund funded projects is now regarded as constituting direct payments from the EU to the final recipient: it now by-passes the UK public expenditure control system. There is therefore no longer any need for public expenditure cover for European structural fund payments within the DEL, and DELs have been reduced by the amount of European structural fund cover that they previously contained.

2.12 This change is intended to be budgetarily neutral: and indeed it is neutral in the specific sense that structural fund projects will continue to be funded on exactly the scale that was previously planned: and the change has had no effect on the amount of residual, (that is, non-structural fund cover), provision in departments’ DELs: so there has been no incentive on departments to either increase or decrease their non-structural fund expenditure.

3. Why the change in classification of structural fund receipts is not neutral in respect of Scotland

3.1 While the Treasury change in the handling of European structural fund receipts is neutral in the specific sense described in paragraph 2.12, the change is not neutral in the longer term for Scotland. Why this is so can most easily be illustrated by the following schematic illustration.

3.2 Consider two countries within the UK, denoted by A and B, whose initial DELs are assumed to be, respectively, £1000 million and £100 million per annum. In year 3, both countries are assumed to benefit from an allocation of structural funds: A receives £200m per annum: while B, (reflecting greater need), receives proportionately more, at £40m per annum. Both structural fund programmes last for 6 years, when both programmes terminate.

The ways in which the DEL provisions for A and B are calculated differ, however. For A, additional DEL cover for the full structural fund allocation of £200m is provided in year 3, and lasts for the 6 year length of the structural fund programme. However, the adjustment to the DEL of B is done by a Barnett type relationship, under which B receives an adjustment to its DEL of 10% of the change in A’s DEL. Finally, we complete this hypothetical picture by assuming that in year 6 the new Treasury method for accounting for EU receipts in DEL is introduced.

The following tables then illustrate what happens.

Here, we use the term “gross spending power” to describe the maximum amount of actual expenditure which can take place, funded from DEL or European receipts. Up until the end of year 5, this is limited by the size of the DEL, since under the old system, structural fund expenditure has to have cover within the DEL. From year 6 onwards, gross spending power represents the sum of DEL plus the structural fund allocation.

Table 1: The situation in A

<table>
<thead>
<tr>
<th>Years</th>
<th>A: structural fund allocation (£m)</th>
<th>A: Del (£m)</th>
<th>Gross spending power (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>-</td>
<td>1000</td>
<td>1000</td>
</tr>
<tr>
<td>2</td>
<td>-</td>
<td>1000</td>
<td>1000</td>
</tr>
<tr>
<td>3</td>
<td>200</td>
<td>1200</td>
<td>1200</td>
</tr>
<tr>
<td>4</td>
<td>200</td>
<td>1200</td>
<td>1200</td>
</tr>
<tr>
<td>5</td>
<td>200</td>
<td>1200</td>
<td>1200</td>
</tr>
<tr>
<td>6</td>
<td>200</td>
<td>1000</td>
<td>1200</td>
</tr>
<tr>
<td>7</td>
<td>200</td>
<td>1000</td>
<td>1200</td>
</tr>
<tr>
<td>8</td>
<td>200</td>
<td>1000</td>
<td>1200</td>
</tr>
<tr>
<td>9</td>
<td>-</td>
<td>1000</td>
<td>1000</td>
</tr>
<tr>
<td>10</td>
<td>-</td>
<td>1000</td>
<td>1000</td>
</tr>
</tbody>
</table>

The situation described in Table 1 is entirely straightforward: in year 3, A’s DEL is adjusted upwards by the full amount of the European structural fund allocation: given the change in accounting for EU receipts in year 6, A’s DEL in that year is adjusted down by the full European structural fund allocation - but since structural fund receipts no longer count against DEL, gross spending power remains unchanged, fulfilling the neutrality criterion. When the European structural fund programme terminates in year 9, gross spending power reverts to £1,000 million, the same level as A’s original DEL.

3.3 Now consider the corresponding position for B as shown in Table 2.

Here, changes to the DEL of country B are determined by the Barnett type arrangement. With the increase in DEL provision in A by £200 million in year 3, B’s DEL rises by £20 million: so to find the required public expenditure cover within its DEL for its structural fund allocation of £40m, B will have to squeeze existing programmes within its DEL by £20m. In year 6, with the change in accounting for EU receipts, B’s DEL is reduced by the full amount of its structural fund allocation, that is, by £40m. The effect is indeed neutral in the short term and gross spending power is maintained at £120m. But when the structural fund programme terminates in year 9, B is left with its DEL at £80m, instead of with its original DEL of £100m.

Note that this is purely an effect of the change in the Treasury treatment of EU receipts: if the old treatment of EU receipts had been maintained throughout, then in year 9 country B would have received the negative Barnett
consequential of the reduction in country A’s DEL in that year: and B’s DEL would then have reverted to its original value of £100m.

3.4 The conclusion to be drawn from this schematic example is that the Treasury change in accounting practice is not neutral in the longer term for a country whose DEL is determined by a Barnett type formula. In the particular example given, country B has been permanently disadvantaged in the longer term, purely because of the Treasury change. This arises because, in the circumstances of country B, the Treasury change has in fact altered the rule which determines how gross spending power changes. Under the old system, gross spending power is determined by the size of DEL, which is in turn determined by Barnett: under the new system, changes in the European structural fund related component of gross spending power are determined by changes in country B’s own European structural fund allocation. The fact that, at the time of the change, there is no step change in gross spending power does not get round the difficulty that, once European structural fund allocations start to change thereafter, gross spending power will then be on a different, and non-neutral, path.

3.5 The above example is purely illustrative: but it is not totally unrealistic as regards the position of Scotland. As the example illustrates, a country whose DEL is governed by a Barnett type mechanism loses out as a result of the Treasury change if the following combination of circumstances holds:

- the country initially has a relatively large European structural fund allocation;
- the old system of accounting for structural fund receipts is in use when structural fund allocations are introduced;
- the change to the new system is made before a significant reduction in structural fund allocations.

But this is very much the situation Scotland finds itself in. The old system of accounting for structural fund receipts was used from the introduction of the structural fund until 2006 - which is just before Scotland’s structural fund allocations are due to be significantly reduced. In the very same publication which recorded the Treasury’s change of accounting treatment for EU receipts as from 2006-07, it is also recorded that EU funding of the 2007-13 structural fund programme for Scotland is likely to be only 45% of the funding secured for the 2000-06 programme: (ref: Scottish Executive, 2006). To put these figures in perspective, Scotland’s allocation of structural funds over the period 2000-06 was £1,094 million: (ref: European Committee, 2000).

3.6 This brings us back to the question which we have already posed in paragraph 2.5: how much additional public expenditure cover was actually added to the Scottish Block by means of the Barnett formula as a result of past structural fund allocations to England: and how did this relate to the size of Scotland’s actual structural fund allocations. This is the critical question to which an answer is required before a definitive assessment can be made of whether and by how much Scotland will be disadvantaged in the long term by the accounting change for structural fund receipts.

While, as we have seen, it is not possible to answer this question accurately from published information, it is possible to form a rough estimate based on published sources, provided we take at face value the answer given by the Scottish Secretary of State to the Parliamentary question recorded at paragraph 2.3 above.

3.7 The two sources of information we use are:

<table>
<thead>
<tr>
<th>Years</th>
<th>B: Structural fund allocation (£m)</th>
<th>b: DEL (£m)</th>
<th>Gross spending power (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>-</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>2</td>
<td>-</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>3</td>
<td>40</td>
<td>120</td>
<td>120</td>
</tr>
<tr>
<td>4</td>
<td>40</td>
<td>120</td>
<td>120</td>
</tr>
<tr>
<td>5</td>
<td>40</td>
<td>80</td>
<td>120</td>
</tr>
<tr>
<td>6</td>
<td>40</td>
<td>80</td>
<td>120</td>
</tr>
<tr>
<td>7</td>
<td>40</td>
<td>80</td>
<td>120</td>
</tr>
<tr>
<td>8</td>
<td>40</td>
<td>80</td>
<td>120</td>
</tr>
<tr>
<td>9</td>
<td>-</td>
<td>80</td>
<td>80</td>
</tr>
<tr>
<td>10</td>
<td>-</td>
<td>80</td>
<td>80</td>
</tr>
</tbody>
</table>

Overall, despite its total structural fund allocation of £240 million, B achieved an increase in gross spending power, over the 6 years when it was in receipt of structural funding, of only £120 million in total. Further, to achieve this, the total displacement of existing spending within B’s DEL over the period was no less than £360 million, (comprising £240 million for matched funding, and £120 million for public expenditure cover). This would have been the situation anyway, whether or not the change in accounting practice had been made in year 6. The sting in the tail, however, is that, because of the change in accounting practice, B will suffer a permanent reduction in gross spending power of £20 million, in every year from year 9 on- in perpetuity. Country B might well ask itself, in these circumstances, whether it was actually worthwhile receiving any structural fund allocation in the first place.

Table 2: The situation in B

---

3.4 The conclusion to be drawn from this schematic example is that the Treasury change in accounting practice is not neutral in the longer term for a country whose DEL is determined by a Barnett type formula. In the particular example given, country B has been permanently disadvantaged in the longer term, purely because of the Treasury change. This arises because, in the circumstances of country B, the Treasury change has in fact altered the rule which determines how gross spending power changes. Under the old system, gross spending power is determined by the size of DEL, which is in turn determined by Barnett: under the new system, changes in the European structural fund related component of gross spending power are determined by changes in country B’s own European structural fund allocation. The fact that, at the time of the change, there is no step change in gross spending power does not get round the difficulty that, once European structural fund allocations start to change thereafter, gross spending power will then be on a different, and non-neutral, path.

3.5 The above example is purely illustrative: but it is not totally unrealistic as regards the position of Scotland. As the example illustrates, a country whose DEL is governed by a Barnett type mechanism loses out as a result of the Treasury change if the following combination of circumstances holds:

- the country initially has a relatively large European structural fund allocation;
- the old system of accounting for structural fund receipts is in use when structural fund allocations are introduced;
- the change to the new system is made before a significant reduction in structural fund allocations.

But this is very much the situation Scotland finds itself in. The old system of accounting for structural fund receipts was used from the introduction of the structural fund until 2006 - which is just before Scotland’s structural fund allocations are due to be significantly reduced. In the very same publication which recorded the Treasury’s change of accounting treatment for EU receipts as from 2006-07, it is also recorded that EU funding of the 2007-13 structural fund programme for Scotland is likely to be only 45% of the funding secured for the 2000-06 programme: (ref: Scottish Executive, 2006). To put these figures in perspective, Scotland’s allocation of structural funds over the period 2000-06 was £1,094 million: (ref: European Committee, 2000).

3.6 This brings us back to the question which we have already posed in paragraph 2.5: how much additional public expenditure cover was actually added to the Scottish Block by means of the Barnett formula as a result of past structural fund allocations to England: and how did this relate to the size of Scotland’s actual structural fund allocations. This is the critical question to which an answer is required before a definitive assessment can be made of whether and by how much Scotland will be disadvantaged in the long term by the accounting change for structural fund receipts.

While, as we have seen, it is not possible to answer this question accurately from published information, it is possible to form a rough estimate based on published sources, provided we take at face value the answer given by the Scottish Secretary of State to the Parliamentary question recorded at paragraph 2.3 above.

3.7 The two sources of information we use are:
a) population figures for Scotland and England, published in the Annual Abstract of Statistics: (ONS, 2006);

b) estimates published in successive volumes of Regional Trends, which show structural fund allocations to the four countries of the UK: (ONS, various dates).

<table>
<thead>
<tr>
<th>Year</th>
<th>Population ratio S/E (2)</th>
<th>SF allocation ratio S/E (3)</th>
<th>Ratio of line (2) to line (3)</th>
</tr>
</thead>
<tbody>
<tr>
<td>95/96</td>
<td>0.1055</td>
<td>0.2861</td>
<td>0.37</td>
</tr>
<tr>
<td>96/97</td>
<td>0.1049</td>
<td>0.2853</td>
<td>0.37</td>
</tr>
<tr>
<td>97/98</td>
<td>0.1044</td>
<td>0.2693</td>
<td>0.39</td>
</tr>
<tr>
<td>98/99</td>
<td>0.1034</td>
<td>0.2677</td>
<td>0.39</td>
</tr>
<tr>
<td>99/00</td>
<td>0.1028</td>
<td>0.1845</td>
<td>0.56</td>
</tr>
<tr>
<td>00/01</td>
<td>0.1024</td>
<td>0.1805</td>
<td>0.57</td>
</tr>
<tr>
<td>02/03</td>
<td>0.1018</td>
<td>0.1745</td>
<td>0.58</td>
</tr>
<tr>
<td>03/04</td>
<td>0.1014</td>
<td>0.1688</td>
<td>0.60</td>
</tr>
<tr>
<td>04/05</td>
<td>0.1014</td>
<td>0.1489</td>
<td>0.68</td>
</tr>
<tr>
<td>05/06</td>
<td>0.101</td>
<td>0.1489</td>
<td>0.68</td>
</tr>
</tbody>
</table>

The final row in this table is an estimate of the ratio of the amount of additional public expenditure cover which the Scottish Block had attracted because of the operation of the structural funds to the actual allocation of structural funds to Scotland: see text.

Based on these two sources, the Scotland to England ratios of population, and also of structural fund allocations, can be derived for the years 1995-96 to 2005-06. The relevant ratios are shown in the first two rows of Table 3. We can see from row 1 that Scotland’s population is roughly 10% of that of England, and declining in relative terms. From the second row we can see that the amount of structural funding allocated to Scotland was 28.61% of that allocated to England in 1995-96, dropping to 14.89% in 2005-06: Scotland has therefore been allocated proportionately more than its population share throughout the period for which we have data, but to a decreasing extent.

As noted earlier, changes to the Scottish DEL are determined by the Barnett formula. If Barnett is applied to the spending allocation for a newly introduced policy in each year from the inception of that policy, then, each year, the change to Scotland’s DEL is Scotland’s population share of the change to the English DEL. This would imply that at any point in time, the total provision allocated to Scotland’s DEL because of that policy will approximately equal Scotland’s population share of the provision for that policy in the English DEL. So for example, in 1995-96, the public expenditure provision allocated to Scotland’s DEL because of structural funds would be Scotland’s population share, that is, 0.1055 of the structural fund provision in England’s DEL. However, from Regional Trends, the structural fund allocation to Scotland, relative to England in 1995-96 was 0.2861. So the proportion Scotland actually received in additional public expenditure cover, relative to the size of Scotland’s structural fund allocation, was 0.1055/0.2861, which equals 0.37. That is, additional public expenditure cover represented 37% of Scotland’s structural fund allocation.

3.8 The figures in the third row of Table 3 imply that, in the early 1990s, Scotland was paying for 63% of its structural fund support on its own, by diverting resources from elsewhere within its DEL. (In fact, given that Scotland also had to provide matched funding for structural fund programmes out of its DEL, the actual diversion of funds in the DEL to meet structural fund commitments would have been 1.63 times the actual structural fund allocation).

By the end of the period, the figures in Table 3 imply that the situation had improved somewhat, with the amount of additional public expenditure cover which the Scottish Block had attracted because of the operation of the structural funds representing just over two thirds of the actual allocation of structural funds to Scotland: hence, at that time, Scotland was paying for 32% of its structural fund support by diverting resources from elsewhere within its DEL.

In terms of money amounts, the estimates in Table 3, taken together with Scotland’s planned structural fund allocations, imply that the shortfall in the Scottish DEL as regards public expenditure cover for structural fund allocations would have amounted to some £810 million in total, over the years 1995-96 to 2005-06.

3.9 Note however, that the figures in row 3 of Table 3 can at best be fairly imprecise estimates of the amount of additional public expenditure cover in Scotland’s DEL relative to the size of Scotland’s structural fund allocation. This is because, for the reasons noted in paragraph 2.5, it is difficult to believe that the Barnett formula or an equivalent was actually applied in a pure form throughout the period since the structural fund was started. There is a need for the government to produce better estimates, based on auditable data. Until this happens, the Table 3 figures represent the best estimates available.

3.10 The implications of the estimates in Table 3 are serious, when considered in conjunction with the effects of the Treasury change in accounting practice for EU receipts. Table 3 implies that Scotland’s structural fund programme was only funded to the extent of 68% by way of genuinely additional cover in its DEL immediately before the change in accounting practice in 2006. Further, in the six years after the change in accounting practice, there is projected to be a 55% drop in structural fund allocations to Scotland: (ref: Scottish Executive, 2006). As we have shown above in the schematic example, after the change in accounting practice the changes in gross spending power are determined directly by changes in Scotland’s structural fund allocation. Hence, by 2013, Scotland will only benefit from the
structural funds to the extent of (68%-55%), that is just over 10% of its current structural fund allocation.

This means that, in 2013 structural funds will channel only a marginal amount of net additional resources to Scotland. Any significant further falls in structural fund allocations thereafter would actually push Scotland into the negative - so that Scotland would be in the ridiculous position of permanently receiving less funding than if the structural fund programme had never been invented. Moreover, even in 2013, although Scotland receives only marginal net funding benefit, structural funds will distort the Scottish budget, both because addtionality has to be shown at local level for the areas within Scotland that are covered by structural fund and because the Scottish DEL has to provide matched funding.

3.11 The conclusion in the preceding paragraph can be expressed in another way. In 2006-07, the Scottish structural fund allocation budgeted for in the Scottish budget was £170 million. According to the estimates in Table 3 above, this would probably have been funded to the extent of 68% by genuinely additional public expenditure cover: meaning that 32%, or £54 million, would be funded by displacement from within the DEL. The effect of the Treasury change is that this £54 million disadvantage then becomes permanently locked in. If Scotland’s structural fund allocation were eventually reduced to zero, then at that time, (and ever after), Scotland’s DEL would be £54 million per annum less than it otherwise would have been. Viewed against a total Scottish DEL of over £25 billion, this effect may not seem large: but the effect is permanent, and it is of a material size.

3.12 As has been noted above, the question of the additionality or otherwise of EU structural funding in Scotland has, in the past, attracted relatively little public attention and debate. The reasons for this are unclear: but one contributory factor must have been the obscure, and in some cases, confusing nature of many government statements on this issue. But in addition, there has also been an element of “swings and roundabouts” in the attitude taken by some commentators: in other words, that what Scotland lost on the swings through the Barnett mechanism, as our structural fund allocations rose relative to England’s, we might in due course regain on the roundabouts as our allocations started to decline in relative terms. Such a view, for example, could be read into the following comment by Professor Heald, in speculating why non-additionality was a less contentious topic in Scotland than in Wales:- “Scotland faces a period of the withdrawal of EU funding, with the corollary of ‘non-additionality of increases’ being ‘non-deductibility of decreases’.” (Heald, 2000)

Now that the Treasury accounting change has broken the swings and roundabouts link, and we start to lose on the roundabouts what we never gained on the swings, it is to be hoped that the whole issue of EU funding in Scotland, both past and present, will be given a thorough public airing.

4. Conclusion

4.1 We draw the following conclusions from the above:

1) The recent Treasury change in the handling of EU structural fund receipts is not neutral in the long term for a country like Scotland, if future significant changes in European structural fund allocations are in prospect, as they are;

2) Our estimates, based on the available published figures, suggest that possibly only 68% of Scotland’s structural fund allocation was backed by genuinely additional public expenditure cover within the DEL when the Treasury changed accounting procedures in 2006. Taken together with the projected 55% drop in structural fund allocation to Scotland by 2013, this implies that in 2013, Scotland will experience only a marginal net funding benefit from the structural fund programme. Any further significant reduction in structural fund allocations thereafter will mean that Scotland will be permanently worse off as a result of the existence of the structural fund programme than it would have been if the structural fund programme had never existed. In addition it will have had its public expenditure programme distorted in order to provide matched funding;

3) Our estimates are inevitably imprecise, given the limitations of the published information available. The critical factor in determining exactly what the long term effect of the accounting changes will be on Scotland is to know how much of Scotland’s structural fund allocation was actually backed by genuinely additional public expenditure cover within the Scottish DEL, at the time when the change in accounting practice took place: (in other words, how much smaller would the Scottish DEL have been at that point, if there never had been a European structural fund programme). The published figures do not enable this critical quantity to be estimated with accuracy. It is of vital importance that the government makes this information publicly available, providing credible, and verifiable, estimates of the key quantity: namely, the amount of genuinely additional public expenditure cover for structural funds within the Scottish DEL at the time of the accounting change.

4.2 Our primary concern in this paper is with the future implications of the recent accounting change for EU receipts. However, publication of the detailed historical data which, we argue, is now required, would provide the additional bonus of settling, once and for all, the vexed question of how much additional public expenditure cover Scotland did actually receive in the past in respect of European structural funds, relative to Scotland’s structural fund allocations.
References


