THE SCOTTISH PUBLIC FINANCES IN 1992/93

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Introduction and Summary

Before the 1992 General Election there was considerable interest in estimating the fiscal position of Scotland within and outwith the United Kingdom. The most authoritative approaches were those of Scottish Office (1992) and BLW/PIEDA (1992). The former outlined a methodology for calculating the Scottish share of UK public expenditure and reported on an exercise conducted annually by Scottish Office officials. The BLW/PIEDA study built on this and outlined an approach to establishing the share of UK fiscal receipts due to Scotland.

This Briefing updates the measures derived in these 2 papers and is designed to inform the ongoing debate on the Scottish Constitution. The latest data available are for the fiscal year 1992/93. In that period, Scotland accounted for 8.8% of the UK population. In that period, Scottish identifiable expenditure was £20.3bn or 10.3% of the corresponding UK total. Total public expenditure to provide services to the Scottish people is estimated at £25.6bn or 9.8% of the UK total of £259.9bn.

In 1992/93, tax receipts due to Scotland were £18.4bn excluding oil and £19.2bn, if two thirds of oil receipts are allocated north of the border. This constitutes 8.2% of UK receipts excluding oil revenues and 8.6% including North Sea taxes and royalties. On either score, the share of Scottish tax receipts are below population share and do not cover identifiable or total Scottish expenditure.

The Scottish budget deficit, excluding oil, is estimated to be a minimum of £7¼ bn and £6.4bn if oil receipts are included. This represents 16.1% of non oil Scottish GDP and 13% of GDP when adjusted for North Sea output. These figures confirm the conclusion of BLW/PIEDA that the Scottish economy has a sizeable structural budget deficit. The remainder of this paper is set out as follows. Section 2 sets out the means of calculating Scotland's share of UK public expenditure whilst Section 3 examines revenues and the Scottish budget deficit. Our concluding remarks are set out in Section 4.

Public Expenditure in Scotland in 1992/93

The approach adopted here closely follows Scottish Office (1992) where a fuller discussion of the issues is contained. The approach deals with 3 broad classes of public spending.

1. Identifiable Expenditure is allocated to Scotland on the basis of the expenditures made to provide a range of services which solely benefit the Scottish people. The broad expenditure types and spend are set out in Table 1. Scottish shares and totals are due to the Statistical Supplement to the 1993 Autumn Statement.

In 1992/93 Scottish identifiable expenditure per capita was £3,968 which compares favourably with £3,290 in England, £3,803 in Wales and £3,411 in the UK. Scottish spending per head is 1.16 times UK levels, Only in Law, Order and Protective Services (95%) does Scottish UK spend per head fall below national levels. Expenditure on Trade, Industry, Energy and Employment is 1.6 times UK levels, Health 1.22 times, Housing 1.21 times and Education 1.27 times.

These generous provisions ensure that Scotland's 10.3% share of identifiable expenditure is higher than the 8.8% population share. These divergences built up in the 1960s and 1970s are reflect the greater need due to Scotland's geography and greater social problems.

2. Non-identifiable Expenditure comprises expenditure which is incurred on providing services to Scotland but which cannot be allocated to the recipient areas. In 1992/93, UK non identifiable expenditure totalled £44.3bn. The main elements are Defence (£23.6bn), Overseas Services (£5.4bn)and Miscellaneous Expenditure (£5.0bn). The latter includes contributions to the EU and expenditure associated with the maintenance of Government, such as tax collection and population registration.

The Scottish Office approach is one of allocating this spend to regions if possible to do so from knowledge of the spend and detailed spending records. Otherwise, GDP share is used to allocate spend to Scotland. In 1990/91, Scotland's share of non-identifiable spend was 7¾% of the UK total.

The 1992/93 share cannot be derived from published data. However, Scottish Office sources suggest that it has increased. Certainly, because of the geography of recession Scotland's GDP share has increased from 8.2% in 1990 to 8.7% in 1992. In this paper we stick with the estimate share for 1990/91 which we believe is extremely conservative. On this basis, non-identifiable expenditure due to Scotland in 1992/93 is projected at £3.4bn.

3. Other Expenditure comprises privatisation proceeds, LA and central government debt interest and various accounting adjustments needed to bring expenditure into line with national accounting procedures. In 1992/93, UK spending on these areas amounted to £18.4bn. In 1990/91, the Scottish Office estimated that 10% of such expenditure was due to Scotland.

It is not possible to replicate these calculations for 1992/93 on the basis of the information set out in the relevant Autumn Statement. Again, the Scottish Office estimate that it has increased from the 10% evident in 1990/91. This is plausible given movements in GDP share, share of Capital Consumption and local authority debt share. In this exercise we have increased Scottish share in 1992/93 to 10¼% which implies that Other Expenditure in Scotland totalled £1.9bn.

Taken together, we estimate that total public expenditure in Scotland in 1992/93 totalled £25.6bn. This represents 9.8% of total UK General Government Expenditure of £259.9bn. Again, this lies above our population share of 8.8%.

Scottish Government Revenues in 1992/93

In this section, we set out our estimates of Government receipts due to Scotland. The approach taken here follows BLW/PIEDA (1992) and involves estimating Scottish share of specific receipts. Table 2 sets out our measures of Scottish revenue before and after oil revenues. The rationale for these shares is as follows-

Income Tax: Scottish share of UK Income Tax is derived from the 1994 Inland Revenue Statistics and is circa 7½%.

VAT and Indirect Taxes: This is derived from the Family Expenditure Survey and is the Scottish share of UK spend on VAT rated goods. In 1992/93 this is circa 7¾%. A similar approach is taken towards Tobacco and Alcohol Duties.

National Insurance Contributions: The 8.4% share of these revenues was supplied by the Scottish Office from UK Treasury estimates.

Local Authority Taxes: Scottish shares of UK council tax and business rates were supplied by the Scottish Office. Scotland accounts for 8.9% of UK non domestic rates which is higher than GDP share of 8.7% and for 9.4% of council tax payments which is higher than the 8.8% population share.

Other Revenues: Shares of other taxes such as non North Sea Corporation Tax and of surpluses and receipts were based on the 1992 GDP share of 8.7%

North Sea Revenues: The 1994 Inland Revenue Statistics indicate that UK oil receipts were circa £1.3bn. Since the UK continental shelf is a separate planning region, these are not due to Scotland. Thus, in our 'ex oil' calculations none of these revenues accrue to Scotland. An alternative would be to allocate these revenues on the basis of population share. This would make little difference to the estimates. In our 'with oil' measure , we assume that Scotland receives two thirds of UK oil & gas receipts.

On this basis, Table 2 presents 2 estimates of government revenue in Scotland. Excluding Oil, Scottish revenues are £18.4 bn of 8.2% of UK non oil revenue. Alternatively, if Scotland receives two thirds of North Sea receipts then Scottish revenues are £19.2bn or 8.6% of total UK receipts. In neither case do revenues cover identifiable expenditure let alone total public spending in Scotland.

Table 3 set outs the Fiscal Deficit in 1992/93 based on the approach set out above. Ex Oil, the deficit is £7¾bn or 16.1% of non oil GDP. With oil, the deficit in £6.4bn or 13.0% of Scottish GDP. These results are broadly in line with those of BLW/PIEDA which are set out in Table 4.

Concluding Remarks

Calculations such as these are subject to a degree of imprecision due to the need to use estimates of shares of elements of both revenue and expenditure. The estimates themselves can be justifiably varied. However, this would not change the fundamental conclusion that Scotland possesses a substantial public sector deficit which, including oil, is likely to be in the region of 10-15% of GDP.

The approach itself can be criticised. The Scottish Office methodology concentrates on isolating the funds required to provide a range of services to the Scottish people. Calculations such as these are produced annually by the Scottish Office, used by the Government of the day but are not normally published. Perhaps this should change and better measures of these of revenue and expenditure share should be undertaken.

An alternative approach seeks to establish the where the money used to provide services is actually spent and is most famously deployed in the Scotland on Sunday series, Scotching the Myth. The sourcing of public expenditure is not unimportant to a regional economy. The greater the first round leakage from expenditure the lower the impact of £1 of public spending on Scottish national income. Higher domestic shares of inputs to public services would increase the ability of a region to sustain the services without transfers. However, this does not affect the cost of providing the services and it is the cost and level of service received that is important. We have little difficulty in endorsing the Scottish Office methodology.

Bain (1995) suggests that such calculations are "limited and problematic". He quotes Bell & Dow as arguing that "Projecting the past pattern of revenues and expenditures into the future misses entirely the point that the purpose of Constitutional change is to ensure that the future is not like the past". All of this is true.

What is also true is that the process of constitutional change will start from such a position. Expenditure currently committed provides services that people want and need and supports jobs and incomes in Scotland and elsewhere. Irrespective of the constitutional arrangements and the changing thrust of policy, it will prove difficult to shift resources between expenditure programmes. Where we are now is extremely important and estimates of the present position form a useful starting point for discussion. To dismiss such estimates could engender further excursions into the political economy of wishful thinking.

Both devolutionists and status quo unionists can justifiably point to the fact that Scotland appears to enjoy a generous fiscal settlement within the UK whilst nationalists appear to be faced with a black hole in the public finances of an independent Scotland. We publish these in order to inform the debate and will conclude by presenting a brief view of what these measures really mean for devolutionists and separatists.

In our view, the existence of budget deficits and substantial transfers of funds from England to Scotland does not undermine the basic case for devolution. However, they are problematic for schemes based on assigning Scottish tax revenues to the Scottish Parliament. These do not cover expenditure and top up grants of one kind or another would come into play. These will require negotiations with the UK treasury and for mechanisms to be put in place to determine such matters. There is a legitimate concern that these may prove destabilising and the exact arrangements have still to be fully specified.

Present proposals affect to give the parliament the scope to 'vary income tax by 3p either way'. The reality is that the Scottish Parliament is not going to get away with establishing income tax rates below those prevailing in the UK. English MPs do and will accept voting transfers to Scotland to support necessary public services. This is part and parcel of being in a Union. However, it beggars belief that English MPs would approve subsidies aimed at allowing Scots to enjoy tax rates lower than their constituents. The only power to cut Scottish taxes will be the power to follow the national rate down.

The existence of budget deficits and fiscal transfers have been wrongly presented as the cost of devolution, The argument runs like this. "There is a budget deficit in funding the budgets to be devolved. This deficit is equivalent of the sums recovered by 19p on the standard rate of income tax in Scotland. This is the cost of devolution." This sort of thinking is misconceived. These costs are real but are presently borne by people South of the Border as part of the costs and benefits of being in a Union.

These transfers will only become the cost of devolution if a UK Government decides to shift the burden of payment to those in Scotland or to bring Scottish spending levels in line with those south of the border. This would be a political decision requiring direct policy measures and not something that would automatically happen and would be part of what Hood (1995) has referred to as a "malevolent scenario". It is hard to believe that a UK Government could engage in cutting Scottish expenditures below need and expect the Union to survive. This whole episode smacks of the politics of Disneyland.

The implications for separatists are more fundamental. It is at this point that we should bear in mind that a government of an independent Scotland would have scope to reduce expenditure or to vary a range of taxes. In our view, taxes have become an issue in industrial location and the power to raise substantial revenues would be illusory. The Labour Party is correct not to devolve business taxation and regulation to their proposed Scottish legislature. In reality, the scope to cut spending in an independent Scotland would arise mainly in the non-identifiable elements particularly defence and overseas services.

All opposition parties believe that investment in people, capacity and infrastructure are necessary to regenerate Scotland. An independent Scottish government would initially require to tax or borrow more just to maintain the present level of services and support. A separate Scottish parliament would appear less well placed to engage in renewal than a devolved legislature or even an unreconstructed union. In this light, we look forward to the forthcoming SNP Scottish budget which promises to cut taxes and increase expenditure. Even in Brigadoon, Kaldor's laws of financial arithmetic will still hold!

References

Bain (1995): Political change promises to harness unique assets.: Scotland on Sunday (19/03/95).

BLW/PIEDA (1992): The Act of Disunion of 1992: Scotland's Economy and Budget Position under both Devolution and Independence within Europe.

Hood (1995): Inward Investment and Scottish Devolution: Towards a Balanced View.

Scottish Office (1992): Government Expenditures and Revenues in Scotland.

Table 1
Scottish Public Expenditure
1992/93

	Identifiable Expenditure(£m)		
	Scotland	UK	shr (%)
Agriculture, Forestry & Fisheries	331	2039	16.2
Trade, Industry, Energy & Employment	730	5147	14.2
Roads & Transport	816	8231	9.9
Housing	652	6120	10.7
Other Environmental Services	1048	9046	11.6
Law, Order & Protective Services	1122	13405	8.4
Education	3647	32573	11.2
National Heritage	157	1326	11.8
Health & Social Services	4405	40990	10.7
Social Security	7178	78003	9.2
Miscellaneous Expenditure	181	299	60.5
Total Identified	20267	197179	10.3
Non identifiable Expenditure	3434	44307	7.8
UK Other Expenditure(£bn)	1.9	18.4	10.3
Total Expenditure	25.6	259.9	9.8
Population(000s)	5111.2	57998.4	8.8

Table 2
Scottish Fiscal Revenues
1992/93

	UK Receipts £ bn	Scottish Share	(Ex Oil) Scottish Receipts £ bn	(Inc Oil) Scottish Receipts £ bn
Receipts	223.9	8.6		19.2
Receipts (ex Oil)	222.7	8.2	18.4	
Inland Revenue	75.7		5.8	6.3
Income Tax	56.5	7.5	4.2	4.2
Non North Sea Corporation Tax	15.0	8.7	1.3	1.3
North Sea Corp Tax	0.7	66.7		0.5
PRT	0.0	66.7		0.0
Capital Gains Tax	1.0	8.7	0.1	0.1
Inheritance Tax	1.2	8.7	0.1	0.1
Stamp Duties	1.3	8.7	0.1	0.1
Customs & Excise	63.4		5.3	5.3
VAT	37.4	7.8	2.9	2.9
Petrol Duty	11.3	7.5	0.8	0.8
Tobacco Duty	6.1	12.2	0.7	0.7
Alcohol Duty	5.1	8.6	0.4	0.4
Betting & Gaming Tax	1.0	8.7	0.1	0.1
Car Tax	0.5	7.5	0.0	0.0
Customs Duties	1.8	8.7	0.2	0.2
Agricultural Levies	0.2	10.3	0.0	0.0
Other Taxes & Royalties	21.7		1.8	2.2
Vehicle Excise Duties	3.2	7.5	0.2	0.2
Oil Royalties	0.5	66.7		0.3
Rates	13.8	8.9	1.2	1.2
Other Taxes & Royalties	4.2	8.7	0.4	0.4
Social Security Receipts	37.4	8.4	3.1	3.1
Council Tax	8.7	9.4	0.8	0.8
Interest & Dividends	5.2	8.7	0.5	0.5
Gross Trading Surplus	4.1	8.7	0.4	0.4
Other Receipts	7.7	8.7	0.7	0.7

Derived from: Financial Statement and Budget Report: 1993/94:
Table 1.2: The Finance of the Public Sector

Table 3
Fiscal Deficit: 1992/93

	£ bn
Total Scottish Expenditure	25.6
Total Scottish Income (exc. Oil)	0.0
Budget Deficit (exc Oil)	25.6
Total Scottish Expenditure	25.6
Total Scottish Income (inc. Oil)	19.2
Budget Deficit (inc Oil)	6.4

Table 4
Scottish Budget Deficit
1990–93

	excluding oil (£bn)		
	GDP	Deficit	% GDP
1990/91	40.37	3.04	7.5
1991/92	42.50	5.85	13.8
1992/93	44.88	7.23	16.1
	including oil (£bn)		
	GDP	Deficit	% GDP
1990/91	44.78	4.69	10.5
1991/92	46.55	6.61	14.2
1992/93	49.29	6.43	13.0

Source: BLW/PIEDA (1992), Stevens (1995)