

(Press Release - 21st August 2019)

Briefing Note: Analysis of ‘Government Expenditure and Revenue Scotland (GERS) 2019’, including implications for a Second Independence Referendum

The Scottish Government today published the latest edition of GERS, covering financial years 2014-15 to 2018-19. This Briefing Note looks at (i) the latest results for Scotland’s fiscal balance (i.e. tax revenues less public expenditure), (ii) projects forward Scotland’s absolute and relative (to the UK) fiscal balance up to 2023-24, and (iii) the implications for a potential Second Independence Referendum.

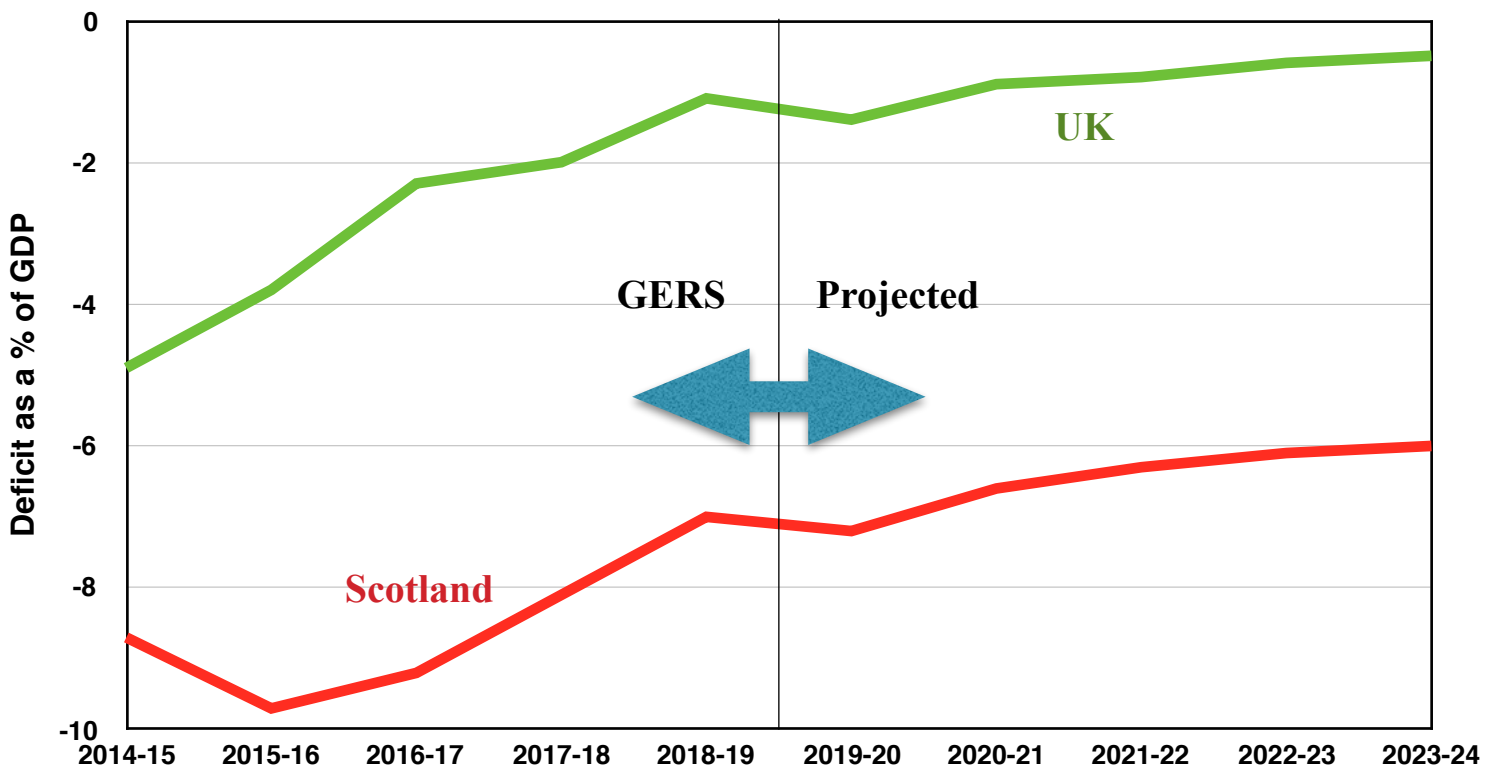
KEY POINTS

- **Scotland’s overall fiscal balance improved by £1.1 billion in 2018-19**, from £-13.8 billion to **£-12.6 billion**. However, revisions to earlier years means that the balance for 2017-18 worsened, by just over £0.3 billion.
- Relative to the size of the economy, **Scotland’s deficit amounted to 7.0% of GDP**, while the UK’s amounted to 1.1% of GDP.
- Scotland’s **relatively poorer position** vs the UK can be explained by the fact that while its population share is 8.2%, its share of onshore Revenues is below this, at 7.8%, and its share of Expenditure is above it, at 9.3%.
- **Looking forward**, the latest OBR forecasts suggest that Scotland’s fiscal balance will worsen a little and then hover just below the £-13 billion mark up to 2023-24 (i.e. around 6% of GDP).
- **North Sea revenue prospects** remain subdued. The latest OBR forecast is of between £1 and 2 billion a year, based on around \$63 a barrel. That range is well below the near £7.5 billion average seen over the period 2005-06 to 2011-12.
- The latest GERS figures confirm that any **Second Independence Referendum** needs to involve greater debate on how an underlying fiscal deficit position, of close to 6% of GDP, might be lowered to a more manageable one, i.e. of 3% or under of GDP (a reduction of £6 to 12 billion). The latest fiscal deficit projections are over £1 billion higher than estimated at the time of the Sustainable Growth Commission work, as a result of new data and a variety of revisions.
- This debate will need to address whether, and if so how, such an adjustment could be managed without a **return to a period of public spending austerity**, both in general terms and specifically with regards to non-NHS budgets.

Scotland's fiscal balance, 2014-15 to 2018-19 (see Table 1 A)

- Scotland's overall fiscal balance (i.e. total Scottish revenues (onshore plus offshore) less total Scottish public expenditure) improved by £1.1 billion in 2018-19, to stand at £-12.6 billion;
- Over the 5 years shown in GERS, Scotland had a notably worse fiscal deficit position (in terms of the size of the deficit as a share of GDP) than the UK in every year. In the past, when offshore revenues were high, the reverse has been the case, although the last time this occurred was in 2011-12;
- Scotland's share of UK expenditure has remained fairly steady at around 9.2 to 9.3% in recent years. However, its share of (onshore) tax revenues has declined from 8.2% to 7.8%.

Chart 1: Scottish and UK fiscal deficits 2014-15 to 2023-24, as a % of GDP



Source: figures for 2014-15 to 2018-19 are taken from GERS 2019, while figures for 2019-20 to 2023-24 are the authors own calculations. See also Tables 1A and B.

Scotland's projected fiscal balance, 2019-20 to 2023-24 (see Table 1 B)

Projections of Scotland's overall fiscal balance beyond the years shown in GERS have been made using the following assumptions:

- **UK onshore and offshore (North Sea) revenues and public expenditure totals** are taken from the latest Office for Budget Responsibility (OBR) forecasts (March 2019);
- **Scotland's share of UK onshore tax revenues** is in line with recent years, **7.8%**;
- **Scotland's share of UK public expenditure** is the average for the past 4 years, **9.25%**;
- **Scotland's share of North Sea revenues** is approximated at **100%** (Note: while the historical average is closer to 80%, recent years have seen Scotland's share rise above 100% and this higher share has been retained. However, this share remains difficult to predict.

The main points of interest to emerge from the forecasts are:

- **Scotland's overall fiscal balance** is projected to be just below the £-13 billion mark by 2023-24, equivalent to 6% of GDP.
- **Relative to the UK**, Scotland's fiscal position remains significantly worse (in terms of the size of the deficit as a share of GDP) than the UK. This equates to a differential of around £2,100 per person, or to an adjustment of almost £12 billion that would be needed for Scotland to reach the same fiscal position as the UK.
- **Scotland's future budget position will, in part, be influenced by whether or not its share of UK onshore revenues continues to decline.** Of late, this share has declined from 8.2% in 2012-13 (just below Scotland's population share) to 7.7% in 2016-17, although it has recovered a little since (to 7.8%). The decline has been fairly widespread, including with respect to: Income Tax; National Insurance contributions and VAT. The forecasts in Table 1 B assumes that Scotland's revenue share does not continue to fall, but if this assumption turns out to be overly optimistic then Scotland's fiscal balance would worsen further.

Future North Sea revenues remain highly uncertain. The estimates used in Table 1 B are based on the latest OBR forecasts (March 2019) which assume an oil price of around \$63 (£47) a barrel, similar to the price seen over the last few months. Even if the price were to rise to \$100 a barrel it is estimated (in the most recent (2015) Scottish Government analysis) that NSOR would still be under £3 billion.

(Note: Chart 1 shows a one-off increase in the UK and Scottish deficits in 2019-20. This is due to UK government tax policy changes resulting in a re-profiling of tax payments that reduces revenues for that year.)

Implications for a Second Referendum Debate

As well as acting as a record of the Scottish Government's existing fiscal position, GERS is also the best starting point from which to project forward in order to understand some of the public finance implications of independence.

The future fiscal position of Scotland at the point of independence - based on existing UK, Scottish and EU tax and spend patterns - is illustrated in Tables 1B and 2B. On the assumption that independence took place in 2023-24 then Scotland would inherit a fiscal deficit of nearly £13 billion (or 6% of GDP).

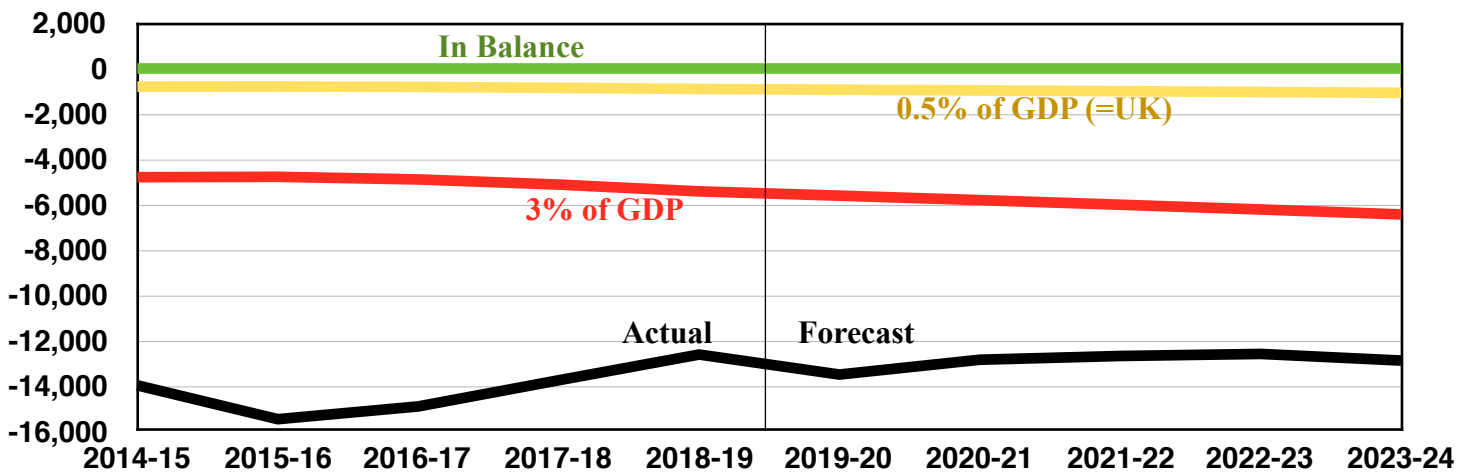
The anticipated size of this deficit is not particularly controversial. The figures shown here are roughly in line with those estimated by other commentators (e.g. the Institute for Fiscal Affairs (IFS)) and with those utilised in the **SNP's Sustainable Growth Commission report (SGCR)** as an independent Scotland's fiscal starting point. In fact, due to the emergence of new data and data revisions the Scottish fiscal balance estimates shown here (in both absolute and relative to the UK terms) are higher than those used in the SGCR, by around £1.5 billion (although roughly the same as a % of GDP). Again, such shifts are largely non controversial and there may be further changes, potentially in either direction, to come.

Such a level of inherited deficit would need to be brought down to a more manageable level. However, what this target level should be is open to debate and the final choice will significantly affect the size of the adjustment made. For example:

- the shift from a fiscal deficit of 6% of GDP to one of around 3% is equivalent to around a £6.5 billion reduction in the Scottish deficit (as shown in Table 2 B). (Note: a 3% target is seen by some commentators as necessary in order to reach a 'stable' fiscal position, i.e. one which could be comfortably financed);
- the shift from 6% of GDP to the UK average of 0.5% of GDP is equivalent to a near £12 billion reduction (again, as shown in Table 2 B). (Note: this equates to the same level of deficit per head as seen at the UK level.)

The latter figure (£12 billion) is what is effectively being lost as a result of Scottish independence from the UK. (In other words, £12 billion is the extra funding Scotland receives from being part of the UK, due in part to higher needs based on criteria such as geography, economic and social conditions, etc and partly on non-needs based historical accident.) The former figure (£6.5 billion) is a sub-set of this, i.e. it involves a £6.5 billion reduction in the level of the deficit along with moving to a higher on-going deficit level than is seen for the UK (i.e. up from 0.5% to 3% of GDP).

Chart 2: Illustrations of different sizes of Scottish fiscal deficit



Source: GERS 2019 and authors own calculations

Note: in terms of how different balances would affect the Scottish budget post independence (based on 2023-24):

1. In Balance: the Scottish Government's Budget is in balance (i.e. Public Sector Revenues = Public Sector Expenditure). This would require a narrowing of the inherited budget of almost £13 billion;
2. 0.5% of GDP: the Scottish Government runs a deficit equivalent to 0.5% of GDP (i.e. in line with the UK's anticipated position). This would require a narrowing of the inherited budget of almost £12 billion.
3. 3% of GDP: the Scottish Government runs a deficit equivalent to 3% of GDP (i.e. in line with what is generally considered to be a 'manageable' deficit). This would require a narrowing of the inherited budget of almost £6.5 billion;

While these starting point estimates are fairly widely accepted, how any such 'sustainable' level of annual fiscal deficit might be reached is much more controversial.

The SGCR looked in some detail at how this starting point might be altered at the point of separation (see <https://static1.squarespace.com/static/5afc0bbbf79392ced8b73dbf/t/5b0a988c352f53c0a5132a23/1527421195436/SGC+Full+Report.pdf>). (Note: the SGCR included projections made by this author to judge what that starting point might be expected to be.) Commentary on the strengths and weaknesses of the SGCR analysis can be found in the Scottish Trends paper 'Reflections on the SNP's Sustainable Growth Commission Report' (see <http://scottishtrends.co.uk/wp-content/uploads/2018/08/GrowthCommissionReview-B.pdf>). Furthermore, the Scottish Trends analysis paper 'Potential impact of Brexit analysis and negotiations on any second Scottish independence referendum' (see <http://scottishtrends.co.uk/wp-content/uploads/2019/02/Brexit-lessons-for-Indyref-II.pdf>) looks at further ways in which fiscal adjustments might be made.

While there are a variety of ways in which the inherited fiscal deficit position might be reduced, many of these will be subject to negotiation at the point of separation. As Brexit has shown, the degree to which any such proposals come to fruition, either at all or on the scale originally foreseen, is difficult to predict in advance.

All of this means that there is a lot at play for in terms of i) how much by, and how quickly, to reduce the inherited deficit, and ii) the degree to which this adjustment should be spread between: increased taxation; reduced public spending, and; increased borrowing.

As the political debate starts to swing away from the outcomes of Brexit and towards the possible implications of Scottish independence, it seems inevitable that greater attention will be focussed on these difficult questions.

So far the post SGCR discussion has been dominated by querying the choice of currency in an independent Scotland and there has been little debate over how best to reduce the size of the fiscal deficit. However, what deficit reduction strategy should apply will clearly be a controversial question, and potentially influential on the outcome of the referendum itself. Greater clarity needs to emerge on this vital issue. If it does not, then pressure may grow for a second, confirmatory, vote, i.e. once a fuller understanding of the implications of independence emerges.

ENDS

Quote:

“This years GERS shows a slight improvement in Scotland’s fiscal balance. However, looking forward Scotland’s deficit remains considerable, at over 6% of GDP, or around £13 billion, and continues to be significantly higher than that seen for the UK.

The comment by the Scottish Finance Secretary at the time of publication that “Scotland’s economy and public finances are strong” seems fanciful given any reasonable analysis of recent low economic growth figures and a still high, by international standards, fiscal deficit.”

The size of Scotland’s inherited fiscal deficit, and how best to deal with it is likely to remain a highly relevant issue if the prospect of a second independence referendum rises. Unlike the currency issue this topic is one that has been little debated by those who favour independence.”

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Table 1 A : Overall fiscal balance, Scotland and the UK, 2014-15 to 2018-19, £ million

	2014-15	2015-16	2016-17	2017-18	2018-19
SCOTLAND					
Onshore Revenues	53,034	53,805	56,245	58,327	61,278
<i>- share of UK revenues</i>	<i>0.1</i>	<i>0.1</i>	<i>0.1</i>	<i>0.1</i>	<i>0.078</i>
Expenditure	68,403	69,339	71,432	73,518	75,338
<i>- share of UK expenditure</i>	<i>0.1</i>	<i>0.1</i>	<i>0.1</i>	<i>0.1</i>	<i>0.093</i>
Onshore Fiscal Balance	-15,369	-15,534	-15,187	-15,191	-14,060
<i>% of GDP</i>	<i>-10.5</i>	<i>-10.5</i>	<i>-10.0</i>	<i>-9.6</i>	<i>-8.5</i>
Scottish North Sea revenues	1,377	49	266	1,425	1,429
<i>- share of UK Total</i>	<i>1</i>	<i>-1</i>	<i>7</i>	<i>1.1</i>	<i>1.16</i>
Overall Fiscal Balance	-13,992	-15,485	-14,921	-13,766	-12,631
<i>% of GDP</i>	<i>-8.7</i>	<i>-9.7</i>	<i>-9.2</i>	<i>-8.1</i>	<i>-7.0</i>
UK					
UK Overall Fiscal Balance	-89,870	-71,840	-44,878	-41,796	-23,533
<i>% of GDP</i>	<i>-4.9</i>	<i>-3.8</i>	<i>-2.3</i>	<i>-1.9</i>	<i>-1.1</i>

Table 1 B : Overall fiscal balance, Scotland and the UK, 2019-20 to 2023-24, £ million

	2019-20	2020-21	2021-22	2022-23	2023-24
SCOTLAND					
Onshore Revenues	63,180	65,754	68,016	70,590	73,242
<i>- share of UK revenues</i>	<i>7.8%</i>	<i>7.8%</i>	<i>7.8%</i>	<i>7.8%</i>	<i>7.8%</i>
Expenditure	77,793	80,013	82,510	85,193	88,338
<i>- share of UK expenditure</i>	<i>9.25%</i>	<i>9.25%</i>	<i>9.25%</i>	<i>9.25%</i>	<i>9.25%</i>
Onshore Fiscal Balance	-14,613	-14,259	-14,494	-14,603	-15,096
<i>% of GDP</i>	<i>-8.6</i>	<i>-8.1</i>	<i>-7.9</i>	<i>-7.7</i>	<i>-7.7</i>
Scottish North Sea revenues	1,100	1,400	1,800	2,000	2,200
<i>- share of UK North Sea revenues</i>	<i>100%</i>	<i>100%</i>	<i>100%</i>	<i>100%</i>	<i>100%</i>
Overall Fiscal Balance	-13,513	-12,859	-12,694	-12,603	-12,896
<i>- % of GDP</i>	<i>-7.2</i>	<i>-6.6</i>	<i>-6.3</i>	<i>-6.1</i>	<i>-6.0</i>
UK					
UK Overall Fiscal Balance	-29,900	-20,600	-18,200	-14,000	-13,800
<i>% of GDP</i>	<i>-1.4</i>	<i>-0.9</i>	<i>-0.8</i>	<i>-0.6</i>	<i>-0.5</i>

Sources: GERS 2019, OBR EFO March 2019, authors calculations.

Table 2 A : Fiscal balance per head, Scotland and the UK, 2014-15 to 2018-19, £ million

	2014-15	2015-16	2016-17	2017-18	2018-19
Scottish Fiscal Balance	-13,992	-15,485	-14,921	-13,766	-12,631
<i>- per head</i>	<i>-2,613</i>	<i>-2,878</i>	<i>-2,758</i>	<i>-2,536</i>	<i>-2,323</i>
UK Fiscal Balance	-89,870	-71,840	-44,878	-41,796	-23,533
<i>- per head</i>	<i>-1,388</i>	<i>-1,101</i>	<i>-683</i>	<i>-632</i>	<i>-354</i>
<i>Per head difference (Scotland - UK)</i>	<i>-1,225</i>	<i>-1,777</i>	<i>-2,075</i>	<i>-1,904</i>	<i>-1,969</i>
<i>Aggregate size of Scottish fiscal deficit cut needed to reach the equivalent UK level*</i>	<i>-6,558</i>	<i>-9,560</i>	<i>-11,228</i>	<i>-10,336</i>	<i>-10,704</i>

Table 2 B : Fiscal balance per head, Scotland and the UK, 2019-20 to 2023-24, £ million

	2019-20	2020-21	2021-22	2022-23	2023-24
Scottish Fiscal Balance	-13,513	-12,859	-12,694	-12,603	-12,896
<i>- per head</i>	<i>-2,470</i>	<i>-2,342</i>	<i>-2,305</i>	<i>-2,281</i>	<i>-2,329</i>
UK Fiscal Balance	-29,900	-20,600	-18,200	-14,000	-13,800
<i>- per head</i>	<i>-447</i>	<i>-306</i>	<i>-269</i>	<i>-206</i>	<i>-202</i>
<i>Per head difference (Scotland - UK)</i>	<i>-2,023</i>	<i>-2,036</i>	<i>-2,036</i>	<i>-2,075</i>	<i>-2,127</i>
<i>Aggregate size of Scottish fiscal deficit cut needed to reach the equivalent UK level*</i>	<i>-11,067</i>	<i>-11,177</i>	<i>-11,211</i>	<i>-11,465</i>	<i>-11,776</i>

Authors calculations.

* This is equivalent to the per head fiscal deficit differential multiplied by the Scottish population. It is also equivalent to, for example, the 5.5% of GDP reduction needed to get from a deficit of 6% of GDP in 2023-24 (i.e. the Scottish level, see Table 1 B) to a deficit of 0.5% (i.e. the UK level).