

Expenditure and Revenue in Scotland: A Review of Methodology

Introduction

The Scotland Office have published a report, 'Expenditure and Revenue in Scotland' examining Scotland's fiscal position since 1980/81, and the ability of expenditure on social protection in Scotland to be funded directly from tax revenue raised in Scotland¹.

The Scotland Office report is apparently based upon the National Statistics publication, Government Expenditure and Revenue Scotland (GERS). GERS is subject to strict guidelines and is compiled in line with National Statistics protocols. All public sector expenditures and revenues are presented in a manner which is consistent with UK National Accounts. All figures and sources are clearly explained and estimates are undertaken by Government Statisticians.

Various sections of the Scotland Office report 'Expenditure and Revenue in Scotland' depart from this assessment, and in doing so make a number of methodological errors. This means the results do not give an accurate picture of Scotland's public finances and are not comparable with the UK Fiscal Accounts or the GERS report. A number of inconsistencies identified in the Scotland Office report are outlined below.

Exclusion of Tax Receipts and Revenues

- In assessing expenditure and revenue in Scotland in section 3 of the Scotland Office report, the analysis excludes council tax revenues, on the grounds that it does not accrue to central government. However, the report includes spending by local authorities in Scotland (which is included as part of 'Scottish Government expenditure' in GERS). This creates an artificial funding gap within the local authority sector of approximately £2 billion in 2007/08.
- The Scotland Office report also departs from GERS by excluding a number of important taxes and revenues which are raised in Scotland and are used to fund public services both in Scotland and at the UK level. In addition to oil revenues, the analysis excludes elements such as the television licence fee, surpluses from public corporations, the fossil fuel levy, water charges, 3G mobile licence fees, rents, regulatory fees, renewable energy obligations, fees from the rail franchise, passport fees, revenues from the National Lottery and a whole host of other smaller UK tax revenues. In total, the analysis in Section 3 of the Scotland Office report underestimates non-North Sea Scottish revenues by approximately £6 billion in 2007/08 and by £14 billion in 2007/08 when inclusive of an illustrative geographical share of North Sea Revenues.

Treatment of Non-cash Elements of the Public Sector Accounts

- Section 3 of the Scotland Office report attempts to isolate depreciation and other non-cash elements from Scotland's public sector accounts. In GERS, as with all National Accounts, depreciation enters as a balancing item (as a revenue in Gross Operating Surplus (GOS) and as an expenditure in the 'Accounting Adjustment'). However, the Scotland Office report's analysis arbitrarily excludes depreciation on the revenue side by omitting GOS but includes it on the expenditure side through the 'Accounting Adjustment'. This creates an apparent expenditure of approximately £1.5 billion in 2007/08 which does not actually take place.

¹ Scotland Office (2010) - Expenditure and Revenue in Scotland - Background Paper
<http://www.scotlandoffice.gov.uk/scotlandoffice/files/Time%20Series%20Analysis%20of%20Government%20Expenditures%20and%20Revenues%20in%20Scotland.pdf>

Time Series Analysis

- The time series analysis prepared in Section 2 of the Scotland Office report is subject to error as it uses various GERS publications which are not directly comparable with each other. For example, in addition to data and methodological revisions, figures for 2001/02 to 2007/08 are now presented on an accruals basis whereas those for 1999/00 and 2000/01 are presented on a cash basis.
- Finally, the Scotland Office report concludes that there is a net fiscal transfer to Scotland from the rest of the UK because expenditures exceeded revenues in Scotland. Irrespective of the accuracy of this calculation, this is a misinterpretation of public sector accounts.
- Running fiscal deficits in any one particular year is common practice in many countries, provided the levels of borrowing are sustainable. For example the UK Government's previous fiscal rules, explicitly allowed for government borrowing in order to finance net investment.
- Recent figures from the OECD show that in 2009, 27 out of the 28 OECD countries are running fiscal deficits. The exception is Norway, which due to its significant oil wealth and building up of an Oil Fund is forecast to run a fiscal surplus of 9.6% of GDP². The same analysis shows that, including North Sea Revenue, the UK is forecast to run the largest fiscal deficit of all OECD countries in both 2010 and 2011, with borrowing double that of the Euro Area average.
- In addition, earlier analysis by the Scotland Office suggests that Scotland has actually been in net fiscal surplus in more years since 1980/81 than the UK as a whole³. This analysis estimated that between 1980/81 and 2007/08 Scotland ran a net fiscal surplus in nine years and would have had a cumulative deficit of £23.5 billion over the period as whole.
- Over the same period, HM Treasury figures show that the UK achieved a net fiscal surplus in six years, and would have had a cumulative deficit of £462.6 billion (£627.7 billion in constant prices)⁴. A per capita share allocated to Scotland would be £38.9 billion (£56.5 billion in constant prices) – twice (i.e. worse) the deficit implied by the Scotland Office⁵.

Conclusion

This note has provided a short review of the analysis contained within the Scotland Office report 'Expenditure and Revenue in Scotland'. As highlighted above, there are a number of methodological weaknesses in the report which have the potential to provide a misleading assessment of Scotland's fiscal position.

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² Source: OECD Economic Outlook November 2009.

http://www.oecd.org/document/61/0,3343,en_2649_34573_2483901_1_1_1_1,00.html

³ Scotland Office (2009) - Scotland and Oil Background Paper

<http://www.scotlandoffice.gov.uk/scotlandoffice/files/Scotland%20and%20Oil%20-%20Background%20paper.pdf>

⁴ Source for all UK figures: HM Treasury Public Finances Databank 22nd January 2010 http://www.hm-treasury.gov.uk/psf_statistics.htm

⁵ Scotland's population relative to the UK is taken to be 8.4%.