

# Light at the end of the fiscal tunnel?

Scotland's public spending pressures





In our accompanying report, *Light at the end of the fiscal tunnel?*, we highlighted the challenges the Westminster government is facing in providing good quality public services for the people of the United Kingdom at a time of spending reductions. Despite over eight years of austerity, these challenges do not appear to be getting any easier.

Indeed upward pressure on public sector pay, dissatisfaction with the quality of some key public services, and the needs of an ageing population are adding to spending pressures. We estimate that an additional £300 billion would need to be spent over the six years to 2023-24 to meet reasonable demands. Within this, Scotland would need £27 billion more than currently planned to cope with future spending requirements.

## Impact of austerity in Scotland

### 2009-10 to date

The effect of austerity is clearly evident in Scotland. After adjusting for general inflation, public spending in Scotland fell from £10,990 per head in 2009-10 to £10,750 per head in 2015-16, a fall of £240 per head. Although

this is smaller than the fall of £475 per head in the United Kingdom as a whole over the same period, it represents a material decline in resources for public services over an extended period when these resources would

normally be expected to increase each year. The decline has not been even as spending per head in Scotland has risen in priority areas, such as health, and where spending is partly demand-driven, like welfare (**Table 1**).

Table 1 Real identifiable public spending by function in Scotland (£ per head, 2016-17 prices)

	2009-10	2015-16	Change	% Change
General public services	251	200	-51	-20%
Public order and safety	535	504	-32	-6%
Economic affairs	1,126	1,016	-110	-10%
of which: enterprise and economic development	210	213	3	2%
of which: science and technology	56	89	33	60%
of which: employment policies	48	44	-4	-9%
of which: agriculture, fisheries and forestry	188	156	-32	-17%
of which: transport	625	514	-111	-18%
Environment protection	270	263	-7	-3%
Housing and community amenities	420	383	-37	-9%
Health	2,261	2,304	43	2%
Recreation, culture and religion	246	203	-43	-17%
Education	1,650	1,500	-150	-9%
Social protection	4,229	4,376	147	3%
<b>Total identifiable expenditure</b>	<b>10,989</b>	<b>10,750</b>	<b>-239</b>	<b>-2%</b>

Source: HM Treasury

But it has fallen sharply in politically and economically significant areas such as transport (down 18%) and agriculture, fisheries and forestry (down 17%).

Even some of the priority spending areas may not have received enough resources to maintain the quality of service expected. As the population ages, more resources are needed to support the elderly. Ageing trends are similar in Scotland to the United

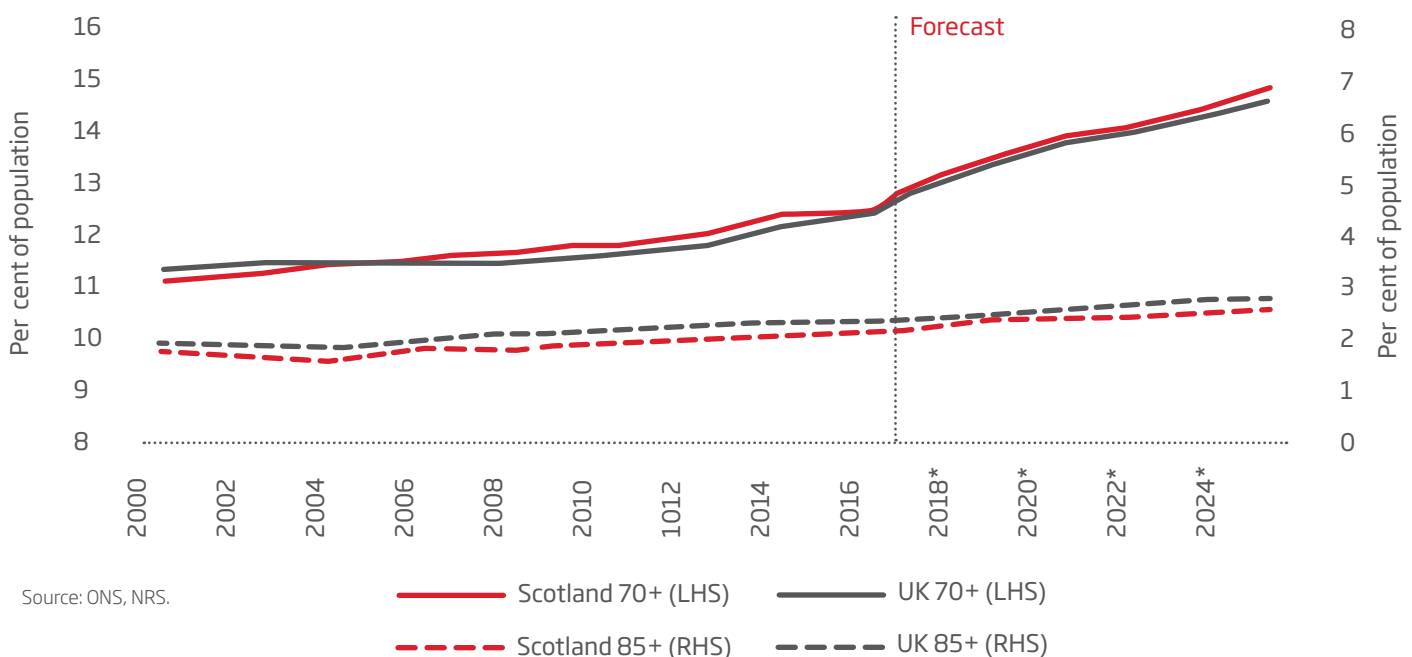
Kingdom as a whole, though people are less likely to reach the age of 85 in Scotland. **Chart 1** shows the share of both populations that are over 70 and over 85. In Scotland, the proportion of the population who are over 70 years old rose from 11.8% in 2010 to 12.6% in 2017 and is expected to rise even more sharply in the near future.

In the decade up to 2009, public sector employment expanded substantially in Scotland, partly

to meet the needs of the elderly. Over the last seven years however, the number of health service staff available to patients has not caught up with rising demand: the number of general NHS staff was reduced from an average of 305 per 10,000 population in 2009 to 299 per 10,000 in 2016. The number of GPs has also fallen by around 2% over the same period (**Table 2, next page**).

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Chart 1: Old age share of population, Scotland and UK



# Impact of austerity in Scotland

2009-10 to date

Similar patterns are apparent in other public services, like education and the police. In Scottish primary education, the number of teachers has not risen in line with the higher number of pupils while in secondary education, the number of teachers was cut proportionally more than pupil numbers fell, causing the number of pupils per teacher to rise by 0.6 and 0.3 in primary and secondary schools, respectively, between 2009 and 2017. The Scottish police force also saw a reduction of nearly 4% over the course of the austerity period.

However despite unprecedented spending restraint, it is still possible for the quantity and quality of public services provided to have improved. In general, this could come about in two ways.

First, when public sector costs are kept low so that more can be purchased with less. Public sector costs have been kept down by public sector pay restraint throughout the United Kingdom. **Chart 2** shows that pay in the public sector has lagged that in the private sector in Scotland and in the United Kingdom as a whole. The growing divergence between pay in the public and private sectors has resulted in increasing recruitment difficulties in a number of areas of the public sector. This means that continued pay restraint in the public sector is unsustainable. However, higher pay will make it even more challenging to deliver public sector services within agreed spending limits.

The second way to improve the quantity and quality of public services without spending more is to increase the efficiency of public service delivery. There is little historical evidence of an improvement in public sector efficiency in the United Kingdom to make up for any shortfall in spending. And for Scotland, survey evidence suggests that the public is becoming less satisfied with the quality of public services provided **(Chart 3)**.

Taken together the evidence suggests that, following a sustained period of fiscal restraint, low levels of public spending have had a detrimental effect on the provision of public services in Scotland, as in the United Kingdom as a whole .

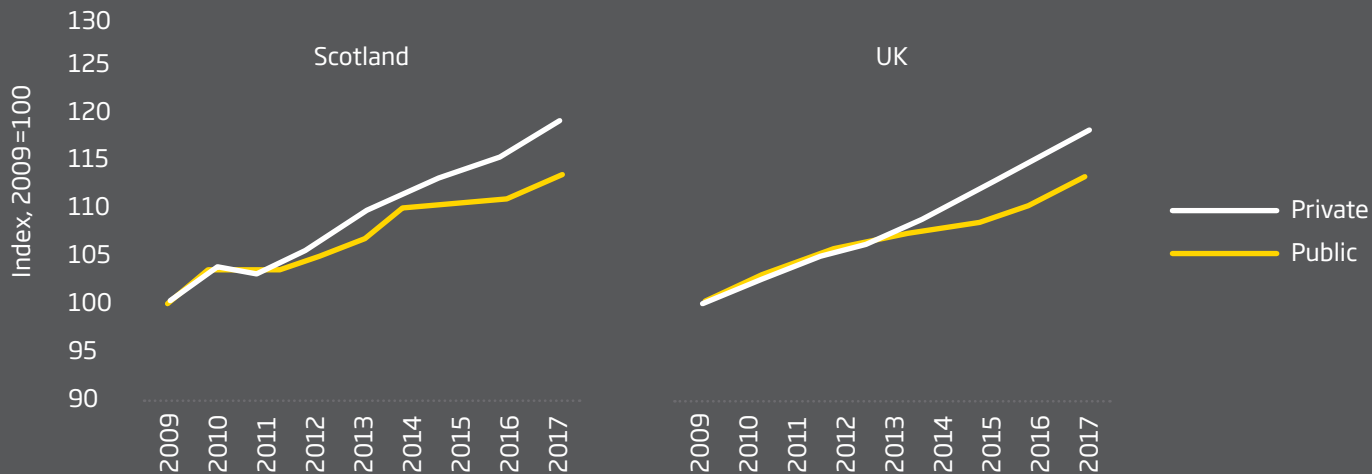
Table 2. Availability of public services to Scottish population

	2009	2017	% Change
NHS Scotland staff per 10,000	305	299*	-2.0%
GPs per 10,000	8.2	8.0**	-2.4%
Percentage of attendees waiting < 4 hours in A&E	96.4***	96.5	0.1%
Pupil-teacher ratio primary schools	15.8	16.4	3.5%
Pupil-teacher ratio secondary schools	11.9	12.2	2.0%
Pupil-teacher ratio special schools	3.4	3.6	7.8%
Police officers per 10,000	33.0	31.8	-3.7%

Sources: IDS Scotland, Welsh Government, Scottish Government.

Notes: \*2016, \*\* 2015, \*\*\*2011.

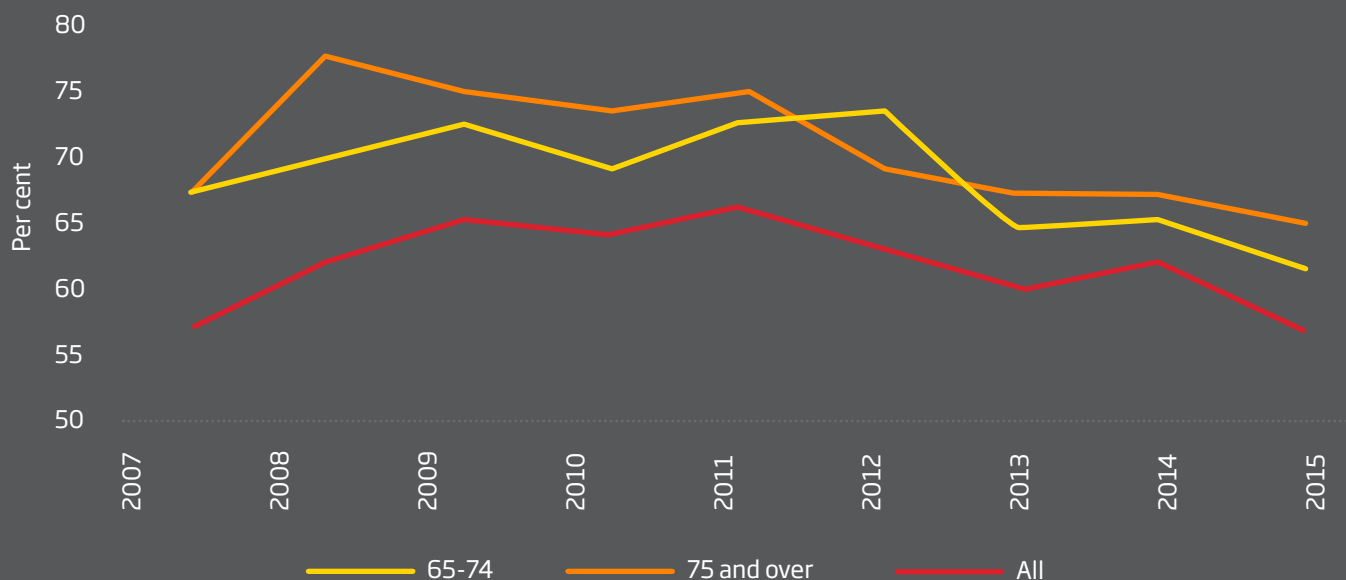
Chart 2: Earnings in the public and private sectors, Scotland and UK



Source: ONS.

Note: Earnings statistics for Scotland are based on median gross weekly earnings data (ASHE). Earnings statistics for the UK are based on average weekly earnings data.

Chart 3: Percentage of respondents satisfied with public services, Scotland



Source: Scottish Household Survey.

Note: Percentage of respondents who are fairly or very satisfied with the quality of local health services, local schools and public transport, by age group.

# Warranted spending

What is the appropriate level of public spending?

This raises the important question of what is the appropriate level of public spending. To calibrate this for the United Kingdom as a whole we have looked at the factors that are likely to have influenced public spending over the entire post-war period. These factors include existing spending commitments, the demand for public services (proxied by the proportion of people who are over 70), the state of the economic cycle, and a judgement of what can be afforded. We then use statistical methods to estimate the importance of these different factors over the post-war period. That allows us to construct an estimate of the amount of public spending that would have been chosen by previous

governments if confronted by the circumstances of today. We call this 'warranted' spending as it reflects the historic choices made by democratically elected governments in the UK.

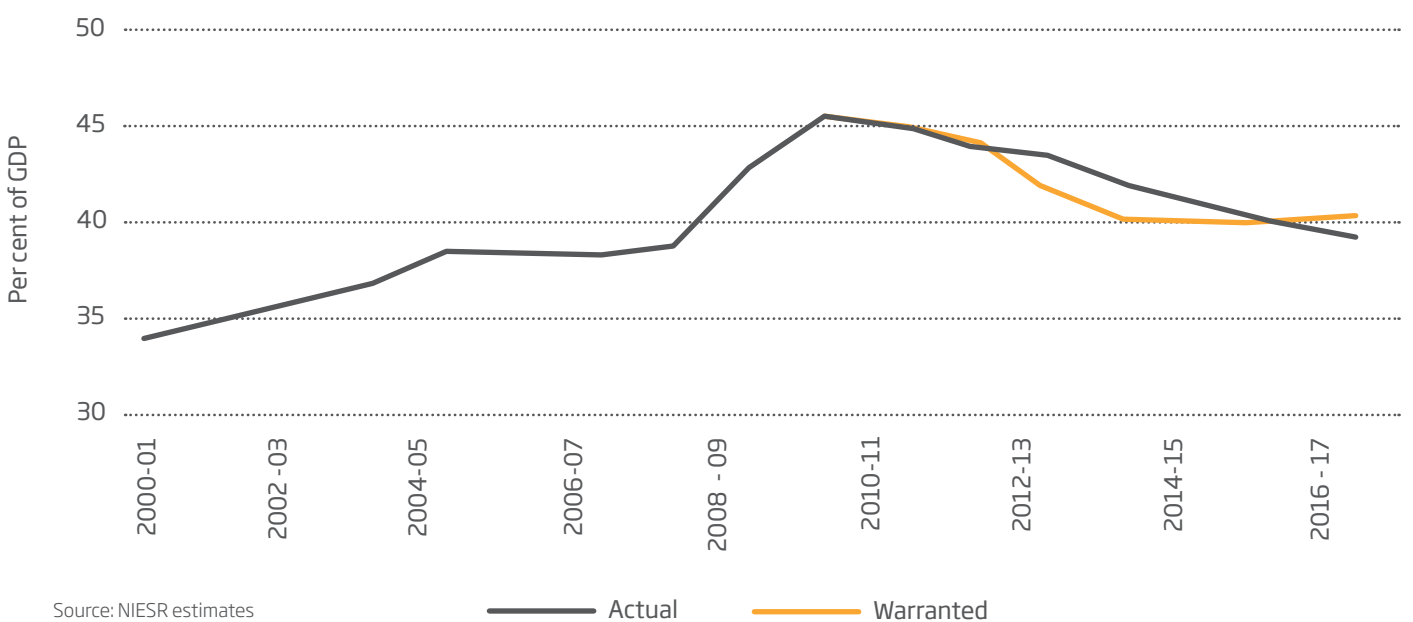
**Chart 4** shows our estimates of warranted spending as a share of GDP over the seven-year period from 2010-11 to 2016-17 in comparison to actual spending.

On this basis, our analysis suggests that the pace of spending reduction between 2010-11 and 2014-15 was actually a little slower than what was warranted (yellow line in Chart 4). However, our analysis shows that after 2014-15, actual spending became more stringent than would

have been warranted by previous governments' spending priorities.

This shortfall of actual spending relative to what is warranted is set to continue in the years ahead. The latest forecast by the Office for Budget Responsibility (OBR), representing its interpretation of the government's declared policy, shows spending continuing to fall from 38.8 per cent of GDP in 2017-18 to 37.6 per cent in 2022-23. But because of population ageing, our estimate of the amount of spending that is warranted rises to 40.2% of GDP in 2022-23, thereby opening up a substantial gap over what is currently planned.

Chart 4: Warranted public spending as a share of GDP



**Chart 5** shows how much extra spending would be entailed by easing austerity in this way. It shows that the government would need to spend over £300 billion more than it is currently planning over the six years to 2023-24 to match our estimate of warranted spending. Of that extra spending, £40 billion is due to the further ageing of the population that is expected over the next six years.

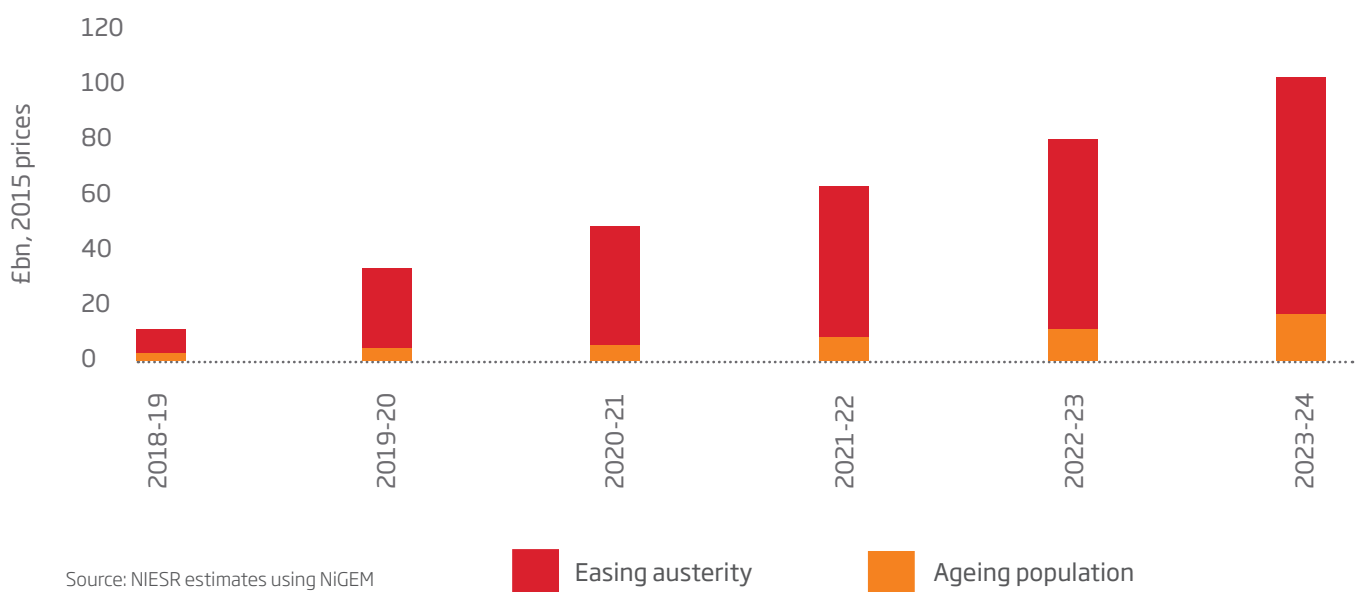
For Scotland, we estimate that around £27 billion more than is currently planned would need to be spent over the six years to 2023-24. This includes spending in

devolved areas as well as spending in areas that mainly fall under the responsibility of the Westminster government. We arrive at this estimate by identifying for the United Kingdom as a whole the spending areas in which the largest gaps have opened up in the recent past relative to demand and where pressures are expected to rise further in coming years. We then allocate the additional spending that is required in Scotland, accounting for changing demographics and the size of the Scottish population as well as the relative importance of different spending functions in Scotland compared to the rest of the

United Kingdom. We estimate that in Scotland, most of the additional spending will need to be focused on health care, economic development and public order and safety.

**For Scotland, we estimate that around £27 billion more than is currently planned would need to be spent over the six years to 2023-24.**

Chart 5: Additional spending in fiscal easing scenario



# Dealing with the challenges ahead

How is Scotland placed to cope with these challenges?

There is little scope for a material increase in public spending in Scotland of this magnitude in the near future. Most public spending in Scotland is managed and allocated by the Scottish government, but it has relatively limited control over the overall amount it spends.

Scotland's public sector budget for any given year is determined by the combined impact of:

- block grant funding allocated by HM Treasury, which is adjusted to reflect taxes devolved to Scotland through Scotland Act 2012 and Scotland Act 2016;
- independent forecasts of receipts generated by those taxes; and
- planned use of available devolved borrowing powers and use of the Scotland Reserve.

The overall block grant allocation has increased in recent years as the responsibilities of the Scottish Parliament have grown, but is primarily determined according to the 'Barnett formula' to reflect changes in public spending decided

by the Westminster government. Spending levels for UK government departments were fixed in the 2015 Spending Review for the period up to 2019-20, and will be agreed for future years in the 2019 Spending Review. As noted earlier, the latest forecast by the Office for Budget Responsibility (OBR) shows spending continuing to fall from 38.8 per cent of GDP in 2017-18 to 37.6 per cent in 2022-23. This will limit the block grant funding that the Scottish government is able to spend.

The Scottish government does have some limited powers to influence the amount it can spend by discretionary changes in taxation or by capital borrowing. In the 2018-19 budget, Scotland's government announced that it would use the powers under the 2016 Scotland Act to raise additional revenues to limit the cuts to Scotland's budget.

It calculated that 'in 2018-19, the cumulative impact of Scottish government decisions on tax and capital borrowing is to reduce the real terms reduction to the Scottish fiscal budget from 8 per cent to

5.1 per cent between 2010-11 and 2019-20, generating an additional £812 million for investment in public services in Scotland in 2018-19 that would not otherwise have been available.'<sup>1</sup>

But this additional spending is relatively small in comparison to Scotland's devolved total managed expenditure of £40.6 billion in 2018-19, and even if sustained over a number of years would not fill much of the gap in spending that we have identified.

With limited scope to increase public spending in Scotland, the most palatable option for improving public services is for the Scottish government to seek radical ways to improve the efficiency with which public services are delivered. This is already an objective of the Scottish government. It stated in its 2018-19 budget that: 'a strong commitment to public service reform lies at the heart of our vision to build an inclusive, fair, prosperous and innovative Scotland that is ready and willing to embrace the future.'<sup>2</sup>

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1.Scottish Government (2017), Scottish Budget: Draft Budget 2018-19, p.5.

2. Ibid., p. 193.



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### Government spending

38.8%



37.6%

# Conclusion

In the accompanying report we suggest that a range of options be investigated that might help improve public sector efficiency. These would include:

- providing incentives to make changes, innovate and improve efficiency
- encouraging private sector discipline and incentives to appropriate parts of public services
- changes to organisation and workforces, including adopting best management practices
- redesigning services and providing alternative delivery mechanisms that empower users to choose most efficient providers
- using technology and data to target or deliver services
- more widespread sharing of best practices.

We would also recommend further research into the effectiveness of the different delivery mechanisms, such as digital and online services provision, that are in place in different parts of the United Kingdom or the rest of the world so that lessons about what works and what does not can be learned and shared. Crucially, though perhaps unsurprisingly, there does not appear to be a single key driver. The challenge for the public sector in Scotland is how to pull these levers simultaneously.

Read the accompanying white paper  
**'Light at the end of the fiscal tunnel'**  
which examines the impact of the fiscal  
freeze on public services across the UK.

**Download the paper here**  
**[www.soprasteria.co.uk/NIESR](http://www.soprasteria.co.uk/NIESR)**



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