

David Hume Institute

*Seminar on
Options for Scotland's Future - the Economic Dimension*

Government Expenditure and Revenue in Scotland (GERS) and North Sea Oil/Gas

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*The paper and presentation have been written in a
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A past, current and future debate

- How reliable is the data and the assumptions underpinning GERS?
- Whose oil is it, what is it worth and how much is in Scottish waters?
- In the past, did Scotland have a fiscal deficit and, if yes, how big was it?
- If Scotland had been allocated North Sea revenues, what would have been the impact on the net fiscal balance?
- What is the likely impact of recent developments (oil price) on past, current and future expenditure and revenue?
- What are the fiscal policy implications of further fiscal devolution (with oil revenue assigned to Scotland and without)?
- What does this tell us about the viability of Scottish public finances and the economic case for fiscal devolution or independence?

How reliable is the data and the assumptions underpinning GERS?

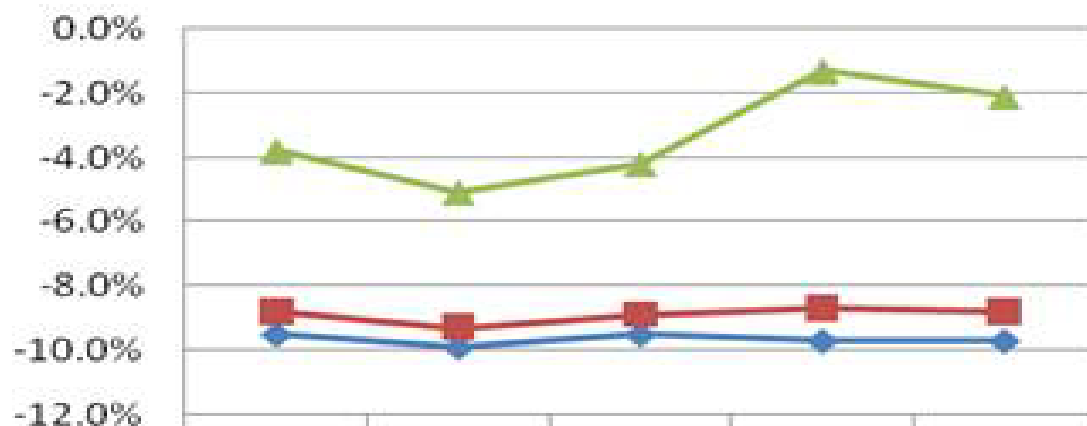
- GERS is an estimate – not fact
- Range of underlying assumptions of how expenditure and revenue is allocated – for example, allocation by population, GDP, actual, etc.
- HM Treasury judgment: What falls under Barnett and what doesn't?
- Treatment of North Sea oil/gas revenue
- Further fiscal devolution – how to value and allocate existing assets and liabilities?
- Much scope for controversy: past, present and future
- But GERS review has addressed many of the long standing issues and most analysts seem to broadly accept the figures
- But delay in figures: latest available is 2006-07
- What does GERS tell us?

Whose oil is it, what is it worth and how much is in Scottish waters?

- Technically it is UK continental shelf – extra territorial
- GERS itself uses scenarios – no oil revenue, population share, geographical share
- Population share makes little overall difference but geographical share does (8.5% vs. 83%)
- Estimate of share comes from Kemp & Stephen – 80% + in Scottish waters
- Revenue figures come from HM Treasury
- Significant variability: Between 3% and 7% of Scottish GDP between 2002-03 & 2006-07 (geographical share)
- Long term decline in North Sea revenue (but depends on tax rates, global oil prices, technology as well as reserves)
- Recent peak in oil prices – higher revenue in 2005-06 (6.8%) & 2006-07 (5.9%)
- Significant uncertainty about current & future revenue

In the past, did Scotland have a fiscal deficit and, if yes, how big was it (with and without oil)?

Net Fiscal Balance (% of GDP)



	2002-03	2003-04	2004-05	2005-06	2006-07
◆ NFB (excl. North Sea revenue)	-9.5%	-9.9%	-9.5%	-9.7%	-9.7%
■ NFB (incl. p.c. North Sea revenue)	-8.8%	-9.3%	-8.9%	-8.7%	-8.8%
▲ NFB (incl. geogr. North Sea revenue)	-3.8%	-5.1%	-4.2%	-1.3%	-2.1%

Some comments on Scotland's net fiscal balance

- Without oil, remarkably stable at - 10% of Scottish GDP
- With oil (population share), little overall difference
- With oil (geographical share), smaller but highly volatile
- Even with oil, a deficit in the net fiscal balance remains
- With oil, current budget (excluding capital spending) shows surplus in 2005-06 (1.2% of GDP) & 2006-07 (0.7% of GDP)

Overall, there appears to be a persistent gap between spending and revenue. If oil revenues (geographical share) are included, volatility increases but the gap is not eliminated. Recent increases in oil revenues lead to a narrowing of the deficit in the net fiscal balance but it is not eliminated. However, there is a surplus in the current budget.

What is the likely impact of recent developments (oil price) on past, current and future expenditure and revenue?

- Oil price reached unprecedented levels but has fallen back
- 2007-08 and 2008-09 revenues highly uncertain
- Last budget estimated revenues of around GBP 10 bn.
- Current Scottish Government estimates are around GBP 14-15 bn.
- Most likely, will result in a healthy surplus in the next two GERS if oil revenues are allocated by geographical share
- However, scale of the surplus remains to be seen: Not only changes in oil price but also all UK revenues will decrease while spending is increasing to deal with the current crisis
- Long term decline in revenues
- Current 'window of opportunity' if oil is allocated to Scotland but it will not last

What are the fiscal policy implications of further fiscal devolution (with oil revenue assigned to Scotland and without)?

Without oil:

- Transfer required to close the gap between expenditure and revenue
- Any reduction in this transfer will mean a gap between expenditure and revenue: Implies debt, lower expenditure and/or higher taxes (revenues)

With oil:

- Transfer replaced by oil revenues
- Current window of opportunity
- But Scottish Government has proposed an oil fund
- Either spend it to close current gap or save/invest it for the future – can't do both
- In principle, an oil fund is a good idea but will require difficult decisions on current expenditure and taxation

What does this tell us about the viability of Scottish public finances and the economic case for fiscal devolution or independence?

- In either case, if the transfer decreases (without oil) or if the Scottish Government is serious about the oil fund (with oil), Scotland needs to address the underlying gap between spending and revenues
- This will require hard decisions on expenditure and revenue (and to resist the temptation of debt)
- But this does not mean that Scotland's economy is not viable under further fiscal devolution or independence
- In the end, it comes down to a choice – any change will have different implications, advantages and disadvantages
- But Scotland's people should fully understand what the different options entail