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The fiscal context for Scottish independence

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ESRC Economic & Social Research Council

Outline

- The UK faces a tough set of choices over public finances up to 2017-18 and beyond
  - Outstanding debt will be at historically high levels for some time
- The Scottish fiscal position is similar to that of rest of UK once oil is accounted for
  - Even including oil may be no better than/worse than, UK by 2017-18
- An independent Scotland would have a range of fiscal choices
  - Fiscal rules, taxes, spending
- Drawing on
  - Green Budget 2013 http://www.ifs.org.uk/publications/6562
  - Scottish independence: the fiscal context http://www.ifs.org.uk/publications/6444

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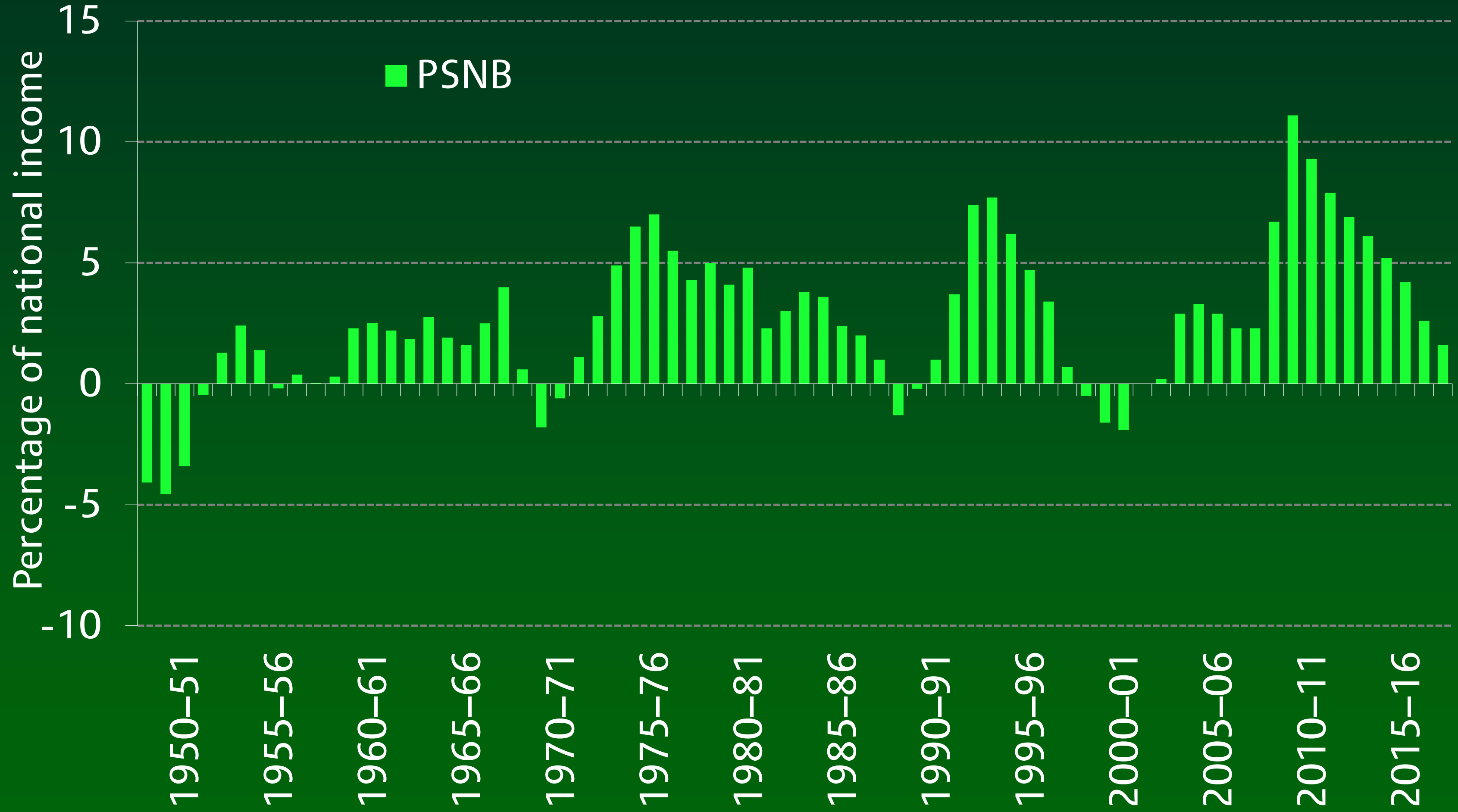
UK public finances

- Deficit gradually falling from post war peak
- Still over 5% of national income in 2014-15
- Planned return toward balance involves very major further spending cuts (or tax increases) thereafter

UK deficit gradually falling from post WW2 peak

And still at over 5% of GDP in 2014-15



Source: IFS calculations; HM Treasury; Office for Budget Responsibility.

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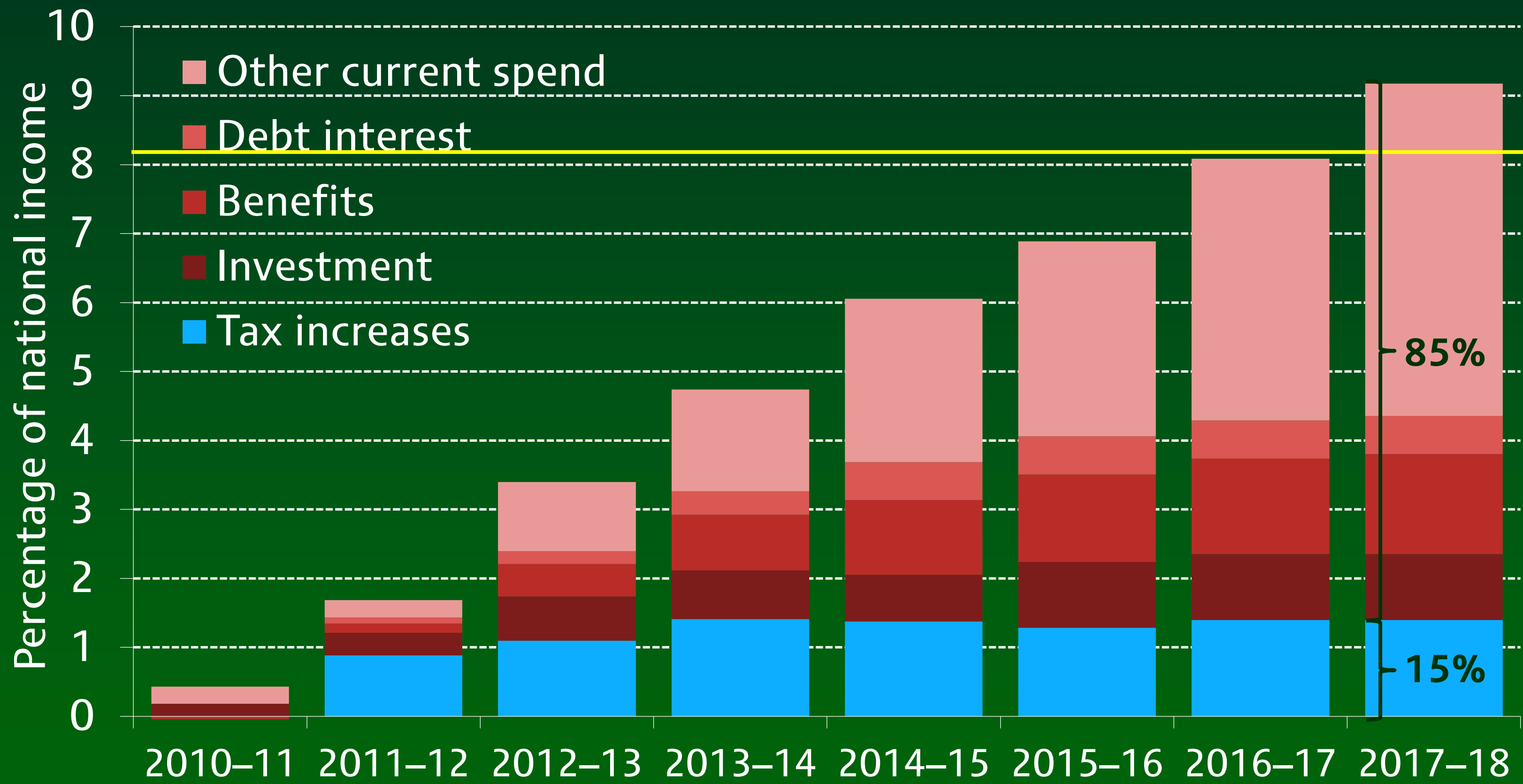
Disease and cure (December 2012)

Dec 2012: 8.2% national income (£129bn) hole in public finances, offset by 9.2% national income (£144bn) consolidation over 8 years



Notes and sources: see Figure 5.8 of *The IFS Green Budget: February 2013*.

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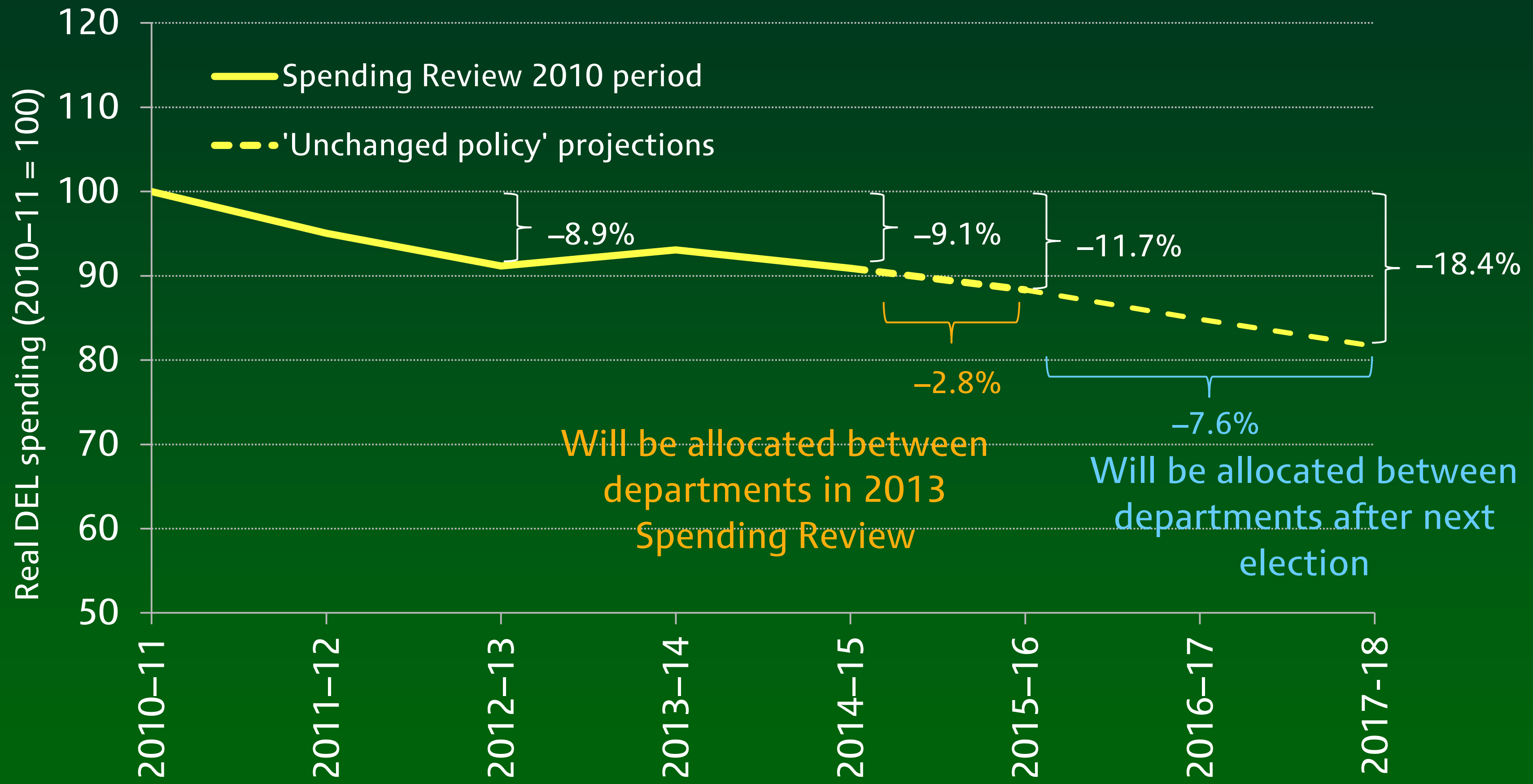
Departmental spending: SR2013 and beyond



Note: DEL figures from 2013-14 are adjusted for changes for local government funding for Business Rates Retention and Council Tax Benefit localisation

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- At over 80% of GDP national debt will be high
  - By historical and international standards

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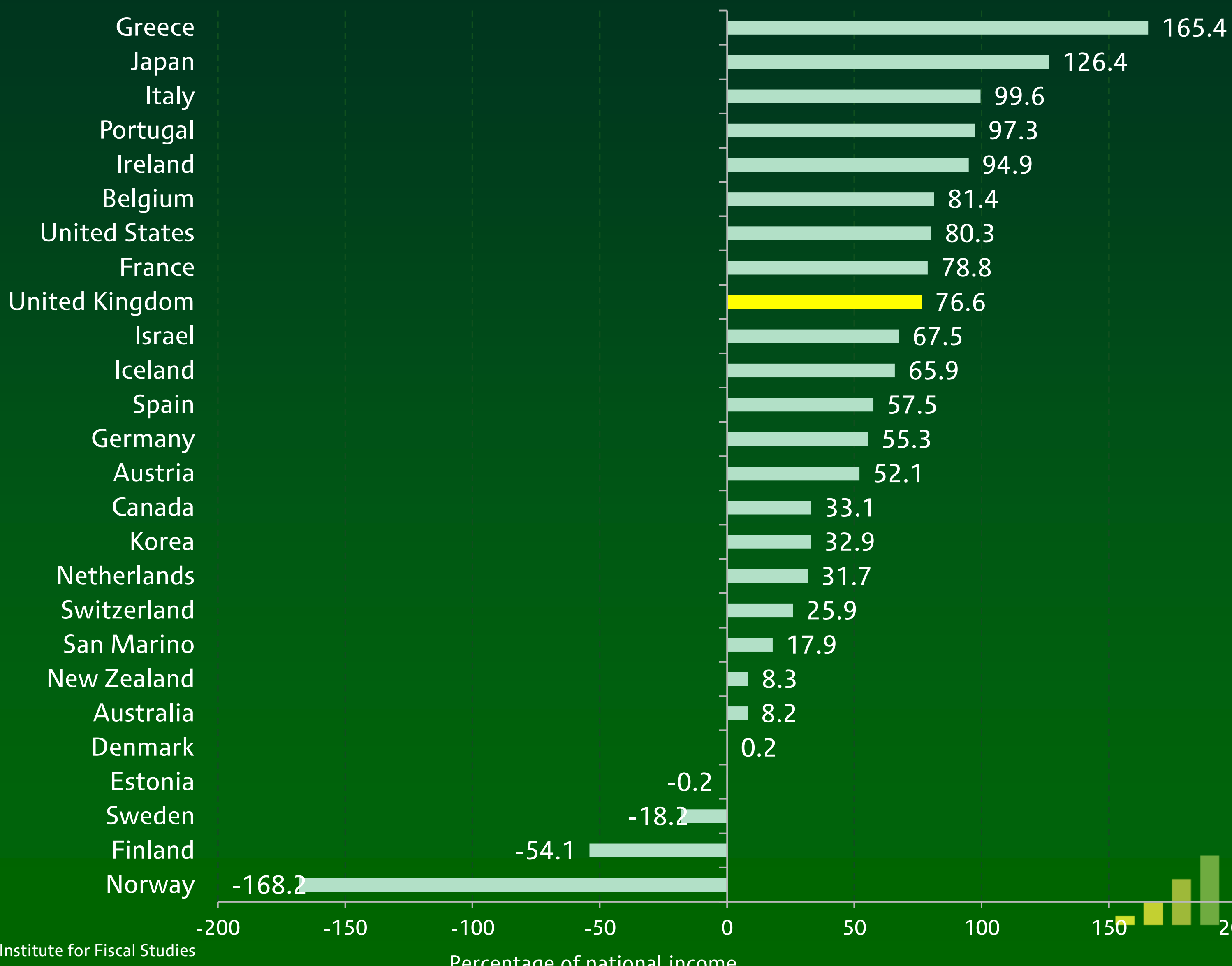
Government net debt as % of national income, 2011



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- At over 80% of GDP national debt will be high
  - By historical and international standards
- OBR projects that fiscal position will worsen significantly in the long run as a result of demographic ageing

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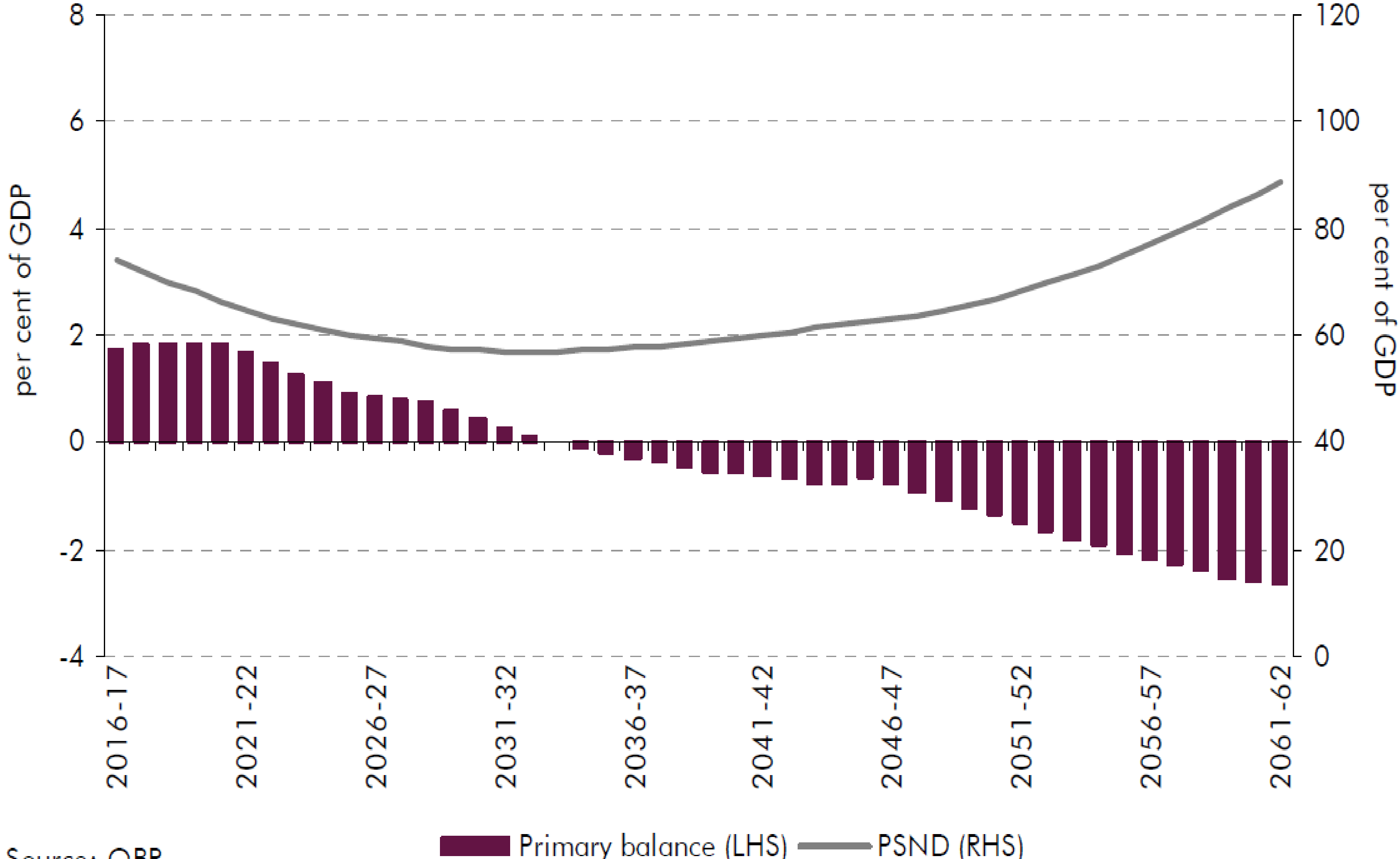
OBR shows fiscal balance worsening by £65bn

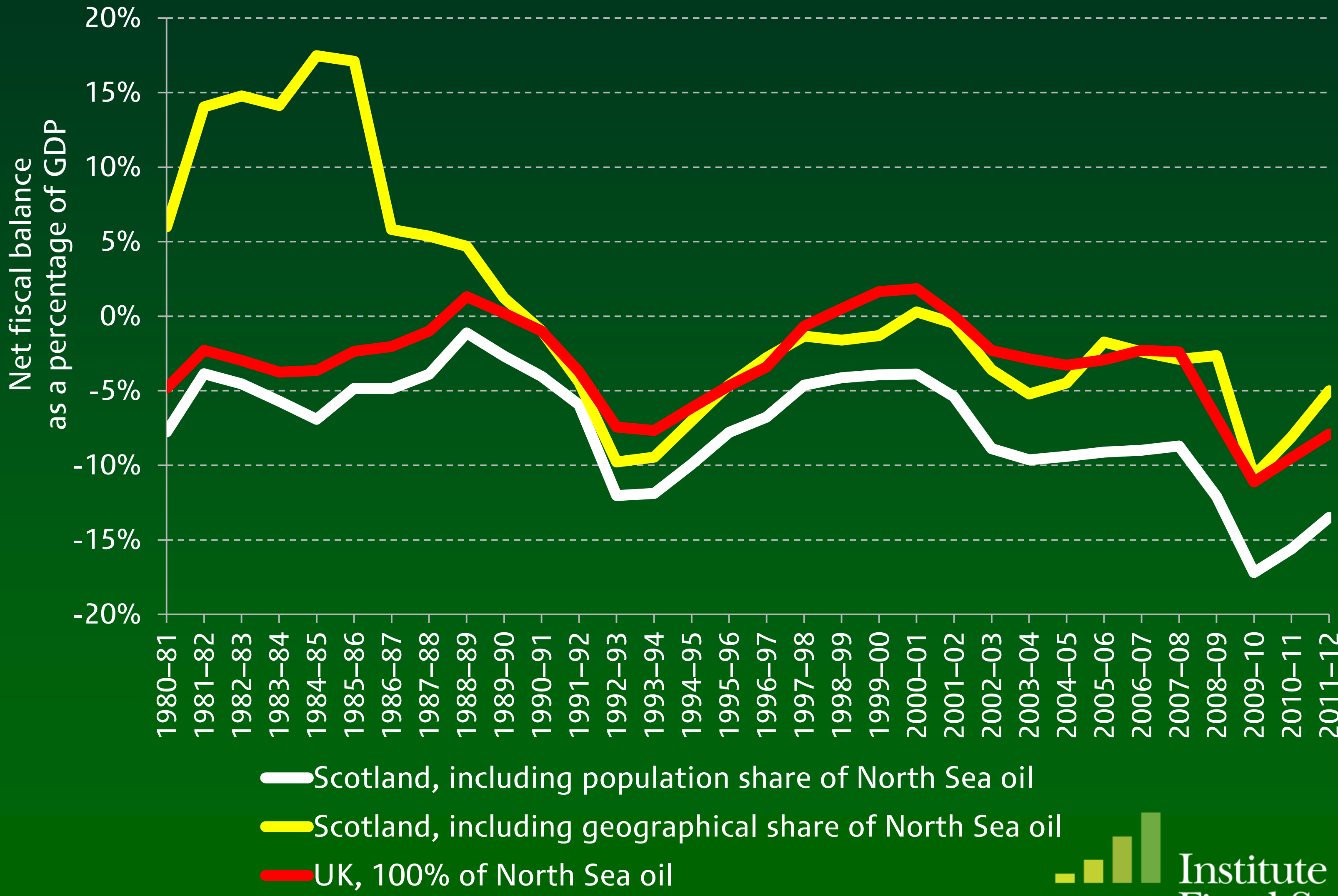


Source: OBR

Scottish position

- Depends on North Sea Oil
  - In recent years in slightly better position than rest of UK when assigned geographical share
  - Considerably worse when not

Net fiscal balance % of GDP, UK and Scotland



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Scottish position

- Depends on North Sea Oil
  - In recent years in slightly better position than rest of UK when assigned geographical share
  - Considerably worse when not
- For well known reasons – tax per head is very similar to rest of UK, spending much higher
  - Income per person is also very similar
- Estimates from CPPR suggest that even including oil the Scottish position will have become worse than UK by 2017-18
  - Of course dependant on uncertain oil revenues

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Projected fiscal deficits as % of GDP

	2012-13	2017-18
Excluding Oil		
Scotland	14.0%	7.9%
UK	8.0%	2.5%

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	2012-13	2017-18
Excluding Oil		
Scotland	14.0%	7.9%
UK	8.0%	2.5%
Including Oil		
Scotland	7.5%	4.4%
UK	7.4%	2.2%

Source: CPPR

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Issues

- All countries are facing fiscal pressures over short, medium and longer terms
- An independent Scotland would need to take some decisions over
  - Fiscal stance
  - Tax revenues
  - Spending

Fiscal stance

- In broad terms likely to involve heading towards medium term current budget balance *excluding* oil revenues
- But is not independent of currency choice
- Independent currency would allow stance to be set independently
- Membership of Euro would require signing up to EU rules
- And if sterling is retained?

Tax revenues UK and Scotland

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Tax issues for an independent Scotland

- There is a great deal wrong with current UK system
  - Independence would provide an opportunity for change
- Specific Scottish differences should impact on design
  - More equal income distribution and different labour market

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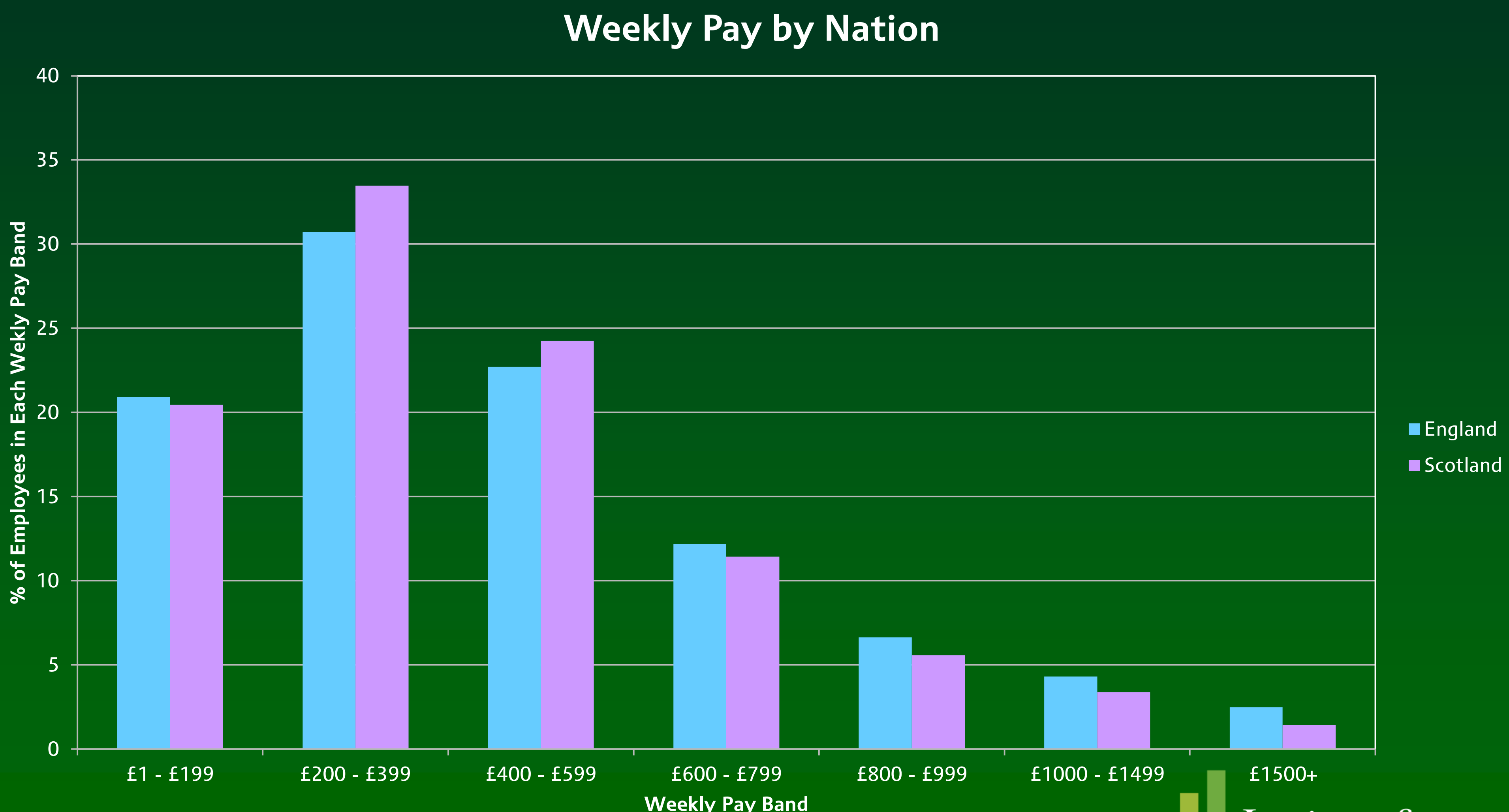
More high earners in England



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Tax issues for an independent Scotland

- There is a great deal wrong with current UK system
  - Independence would provide an opportunity for change
- Specific Scottish differences should impact on design
  - More equal income distribution and different labour market
- Openness to rest of the UK
- Potential for tax competition with rest of UK and need to rely on less mobile tax bases
  - Sustainable revenue may be lower

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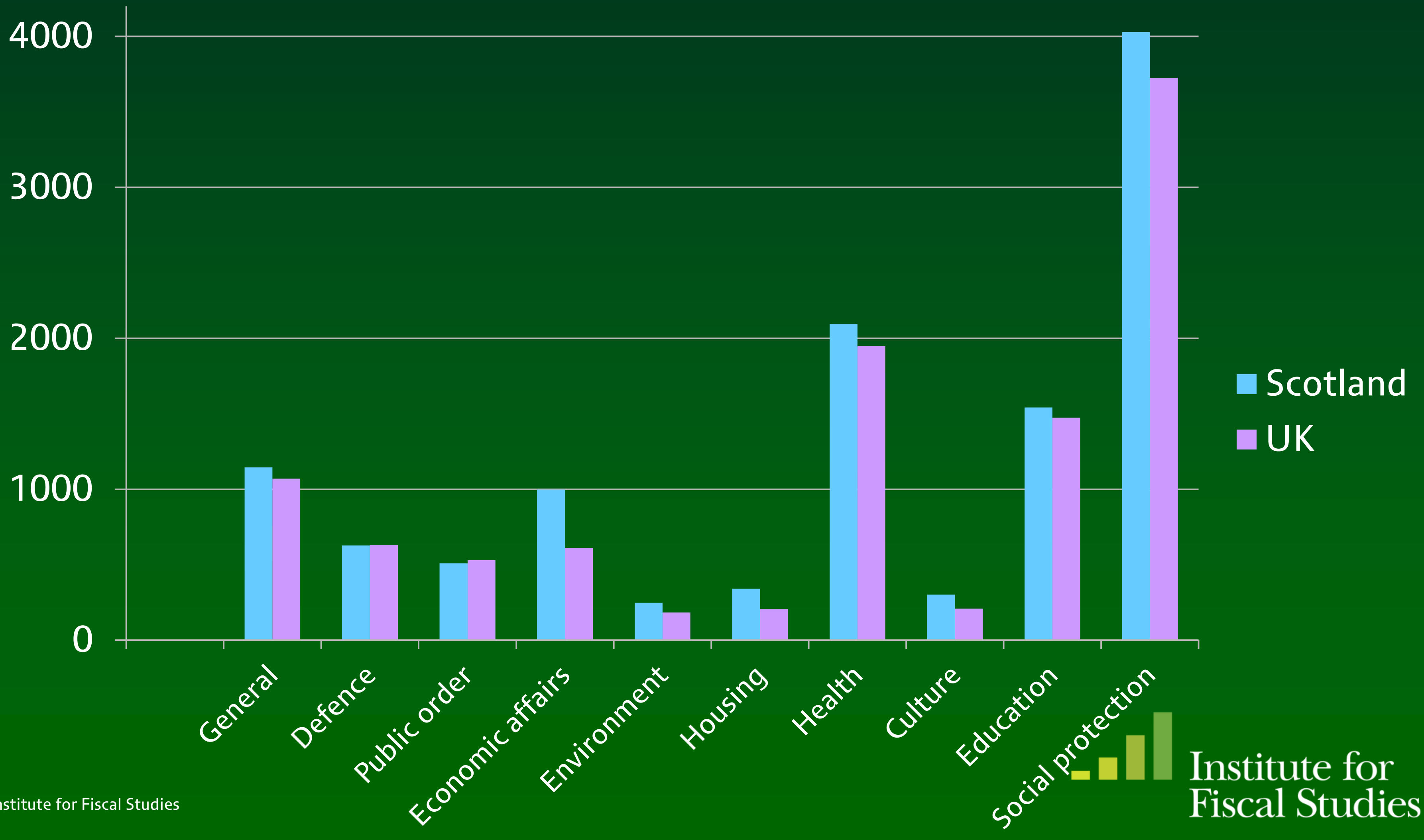
Spending issues for an independent Scotland

- Spending per capita is higher across the board
  - Not just in those areas like HE and social care where specifically different courses have been chosen

Spending per capita UK and Scotland



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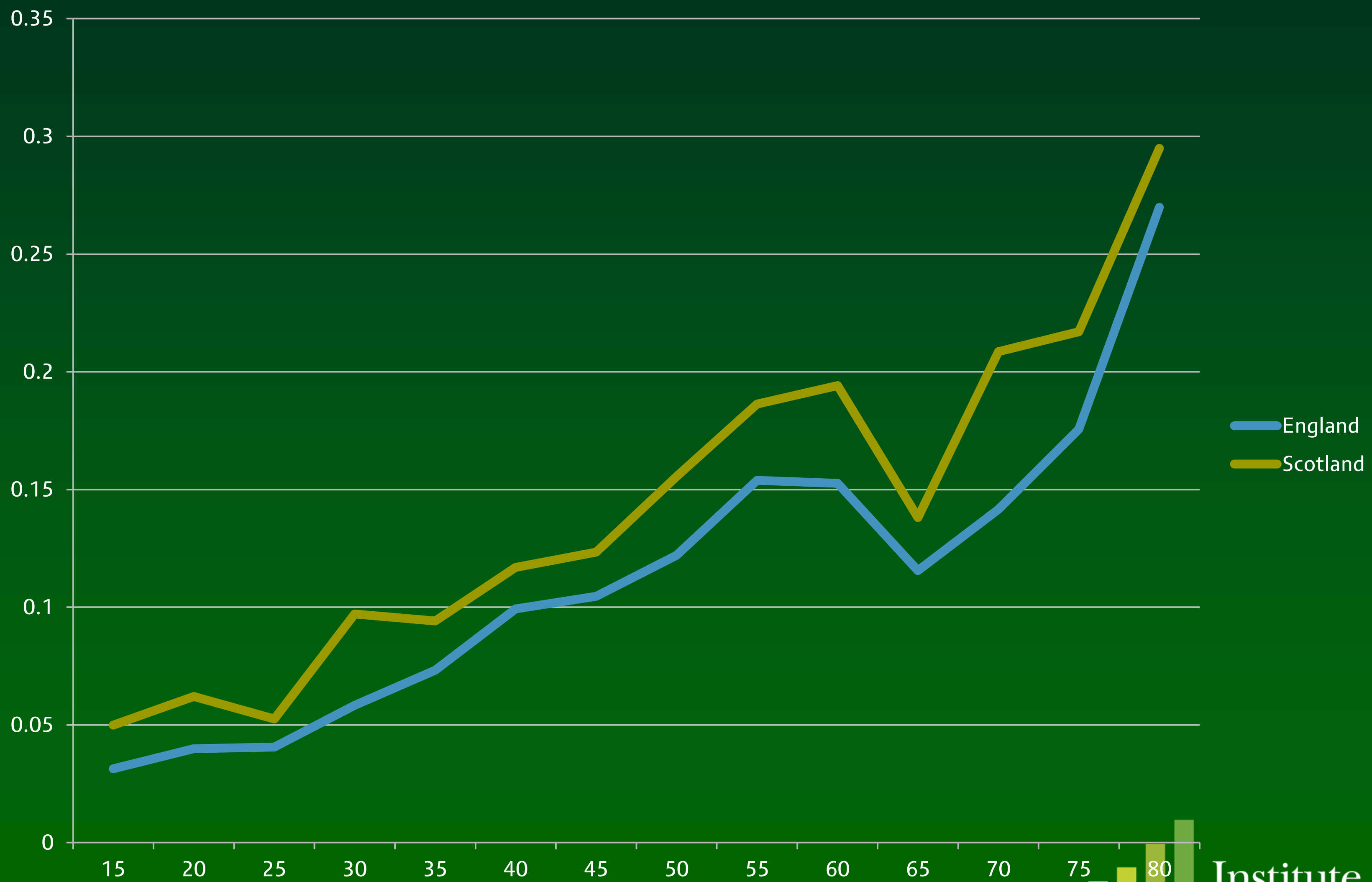
Spending issues for an independent Scotland

- Spending per capita is higher across the board
  - Not just in those areas like HE and social care where specifically different courses have been chosen
- Choices will need to be made on basis of clear analysis of priorities over short and long term
- Opportunities arise from e.g. fact that UK defence spending is significantly higher as a share of national income than the average of smaller countries
- Challenges come from e.g. older demographic structure and greater reliance on sickness and disability benefits

At any age Scots more likely to get disability benefits



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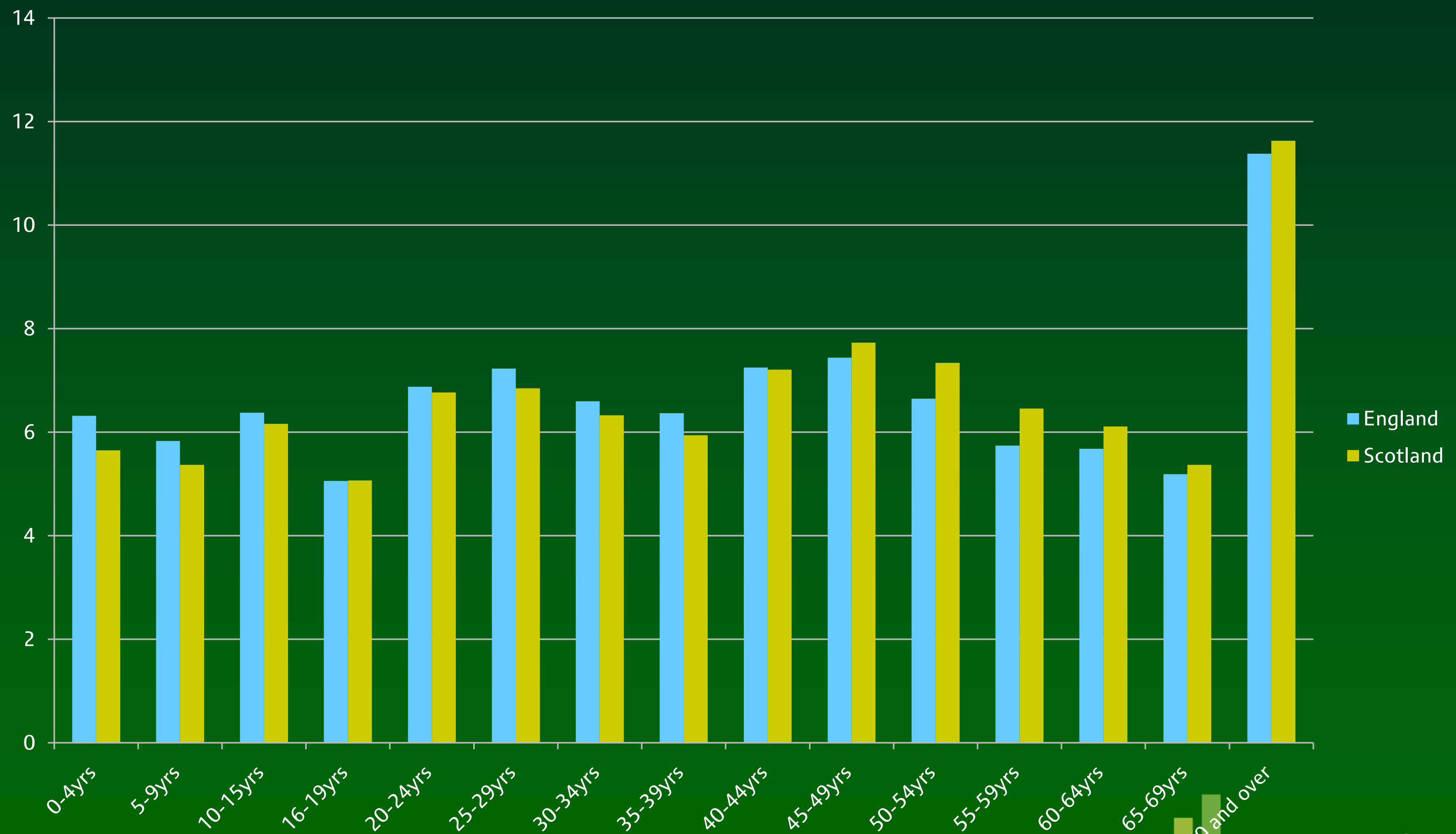
Scottish population is slightly older



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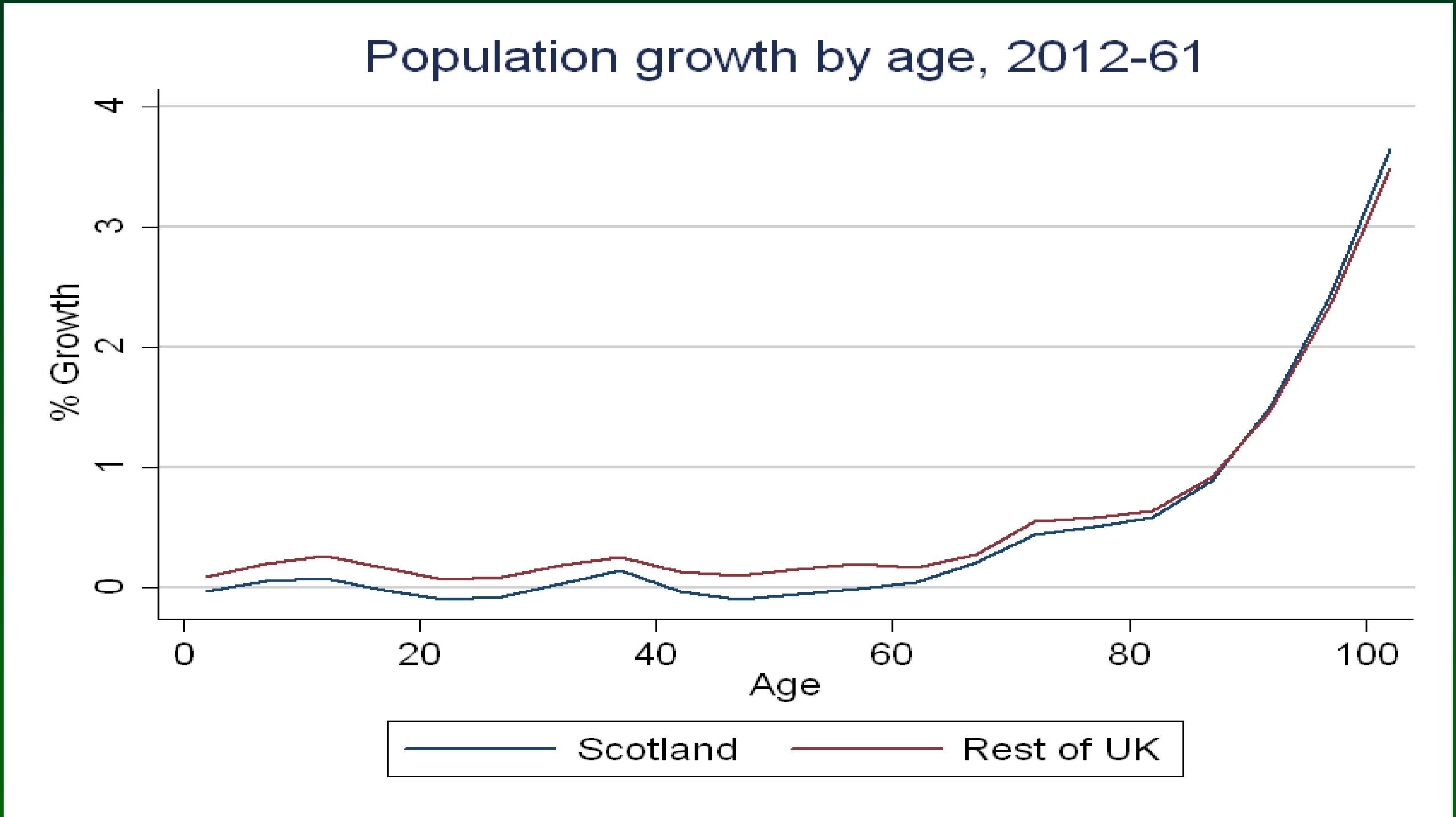
Central prediction is that the gap will grow



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To conclude

- The UK, along with many other countries, is facing difficult fiscal choices in the short and long term
- An independent Scotland would likely inherit an uncomfortably large national debt
  - With luck the annual deficit would be largely under control
- An independent Scotland would have the opportunity to set its own fiscal rules
  - Dependent on its currency choice
- And could implement a more efficient tax system
  - Subject to constraints created by openness and competition
- Like most countries would face tough long term spending choices
  - Perhaps quantitatively somewhat tougher than England