The fiscal context for Scottish independence

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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
  – Scottish independence: the fiscal context http://www.ifs.org.uk/publications/6444
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.
UK public finances

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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*. 
Departmental spending: SR2013 and beyond

Real DEL spending (2010–11 = 100)

Spending Review 2010 period

'Unchanged policy' projections

Will be allocated between departments in 2013 Spending Review

Will be allocated between departments after next election

Note: DEL figures from 2013-14 are adjusted for changes for local government funding for Business Rates Retention and Council Tax Benefit localisation
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
- At over 80% of GDP national debt will be high
  - By historical and international standards
Government net debt as % of national income, 2011

- Greece: 165.4%
- Japan: 126.4%
- Italy: 99.6%
- Portugal: 97.3%
- Ireland: 94.9%
- Belgium: 81.4%
- United States: 80.3%
- France: 78.8%
- United Kingdom: 76.6%
- Finland: 67.5%
- Sweden: 65.9%
- Estonia: 57.5%
- Denmark: 55.3%
- Australia: 52.1%
- New Zealand: 33.1%
- San Marino: 32.9%
- Switzerland: 32.9%
- Netherlands: 31.7%
- Austria: 25.9%
- Korea: 17.9%
- Canada: 17.9%
- Korea: 8.3%
- United States: 8.2%
- Italy: 8.2%
- Spain: 0.2%
- Iceland: 0.2%
- Japan: -0.2%
- Sweden: -18.2%
- Finland: -54.1%
- Norway: -168.2%

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- OBR projects that fiscal position will worsen significantly in the long run as a result of demographic ageing
OBR shows fiscal balance worsening by £65bn
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

- Scotland, including population share of North Sea oil
- Scotland, including geographical share of North Sea oil
- UK, 100% of North Sea oil

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Scottish position

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  – 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
## Projected fiscal deficits as % of GDP

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<th>2017-18</th>
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Source: CPPR
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 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
More high earners in England

Weekly Pay by Nation

- £1 - £199
- £200 - £399
- £400 - £599
- £600 - £799
- £800 - £999
- £1000 - £1499
- £1500+

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Tax issues for an independent Scotland

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  – 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
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
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
Scottish population is slightly older
Central prediction is that the gap will grow
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