

Press Release

Tel: +44 (0) 20 7291 4800
Fax: +44 (0) 20 7323 4780

mailbox@ifs.org.uk
www.ifs.org.uk

7 Ridgmount Street
London WC1E 7AE

Independent Scotland would face long term fiscal challenges

The short run fiscal situation facing an independent Scotland would not look very dissimilar to that facing the UK as a whole, assuming that it would take a “geographical share” of North Sea oil and gas revenues. Public spending per head in Scotland is higher than that in the rest of the UK. Oil and gas apart, tax revenues per head are close to the UK average. If you add in a geographic share of oil and gas revenues then Scottish tax revenues would in recent years have been high enough to slightly more than offset the higher levels of public spending.

But over the longer run if, as seems likely, North Sea oil and gas revenues fall, an independent Scotland would face a bigger fiscal adjustment than the rest of the UK.

If Scotland were to become independent in the second half of this decade it would do so following a long period of public spending cuts across the UK. Yet UK public sector net debt is projected still to be high by recent historical standards, still over 70% of GDP in 2017-18. When you take account of North Sea oil, GDP per head is somewhat higher in Scotland than in the UK as a whole. So if UK debt were shared on a per capita basis then an independent Scotland might inherit a slightly smaller debt to GDP ratio than that faced by the UK. Even then debt would still likely be a good two thirds of GDP, much higher than the UK’s level of debt in the years prior to the recent financial crisis and associated recession.

A new Scottish government would need to put together a fiscal architecture which would set out a long term path to sustainability.

These are among the main conclusions of a new report by IFS researchers, launched in Edinburgh today, which takes an initial look at some of the fiscal consequences of Scottish independence. This is the first output of a new project at IFS, funded by the Economic and Social Research Council (ESRC), looking at some of the fiscal choices that might face Scotland should it choose independence following the 2014 referendum.

Main findings include:

On spending

- Public spending per head is about £1,200 a year higher in Scotland than in the UK as a whole (about £11,800 against £10,600 in 2010-11), and is higher across most areas of government activity. This is despite the fact that household disposable income per head in Scotland is very similar to the UK average;
- Whilst uncertainty over how to allocate spending in some areas like defence might change the magnitude of the difference, it is not big enough to affect the broad conclusion that spending per head is substantially higher in Scotland;

On taxes

- Ignoring North Sea oil and gas, Scottish tax revenues per head are almost the same as the UK average. The composition of Scottish tax revenues is, however, somewhat different. Taxes on income are less

Embargo

Until GMT 00.01 am
Mon 19th Nov 2012

Contacts

IFS Press Office

020 7291 4800
07730 667013

Director:
Paul Johnson

Research Director:
Richard Blundell

The Institute for Fiscal Studies
Limited by Guarantee,
Registered in England: 954616
7 Ridgmount Street
London
WC1E 7AE

Registered Charity: 258815
VAT no: GB 394 5830 17

important than in the rest of the UK, taxes on spending are more important;

- Allocated on a geographic basis, North Sea oil and gas revenues would currently be hugely important to the budget of an independent Scotland. They would have accounted for over 15% of revenues in 20010-11 compared with just 1.6% for the UK as a whole;
- Oil and gas revenues are, though, very volatile. On a geographic basis they were more than 20% of Scottish revenue in 2008-09 but just 12% in 2009-10. Looking back further they accounted for nearly half of all revenue in the mid 1980s, falling to just 3% in 1991-92. This degree of volatility in such an important revenue stream would pose challenges;

On the public finances

- Without oil and gas revenues or, equivalently, assigning them on a population basis, there has been an even bigger gap between spending and tax receipts in Scotland in recent years than in the UK as a whole;
- With a geographic assignment of oil and gas revenues, on the other hand, the gap between revenues and spending in Scotland and in the UK has been similar, indeed somewhat smaller in Scotland;
- Clearly the assignment of oil and gas revenues is crucial. In the short run, depending on oil and gas prices and levels of production, they could slightly more than pay for the additional public spending per head that currently occurs in Scotland relative to the UK as a whole.

On the fiscal architecture and the longer run

- The government of a newly independent Scotland would need to decide whether to have fiscal rules, and if so what they should be, as well as whether to appoint an independent fiscal arbiter in the mould of the UK Office for Budget Responsibility;
- An important decision would revolve around how to treat oil and gas revenues. One possibility would be to aim for budget balance, ignoring oil and gas revenues (as well as investment spending, as the UK Government currently does), several years down the road;
- Like the UK as a whole, and most other developed nations, an independent Scotland would face some tough long term choices in the face of spending pressures created by demographic change. If, as is likely, oil and gas revenues fall over the long run then the fiscal challenge facing Scotland will be greater than that facing the UK.

David Phillips, one of the authors of the report said: “Independence would provide Scotland with an opportunity to set its own fiscal course. In common with all countries it would face constraints and would have to make, sometimes uncomfortable, choices. In the short run its higher public spending than the UK average could be covered by oil and gas revenues if these are assigned on a geographic basis. In the longer run the loss of these revenues would lead to tougher choices than those faced by the UK as a whole.”

ENDS

Notes to Editors:

1. For embargoed copies of the report or other queries, contact the IFS press office: 020 7291 4800 / 07730 667013
2. This is the first publication from a new IFS research programme which aims to clarify some of the fiscal choices that might face Scotland were it to become independent. Outputs associated with this project are being produced by under the auspices of the Centre for Microeconomic Analysis of Public Policy, an ESRC research centre hosted by the IFS. This project forms part of a wider ESRC programme of work addressing issues around the future of the UK and Scotland.
3. **ESRC programme of work “The future of the UK and Scotland”:** The ESRC is supporting a programme of work addressing issues around the future of Scotland. The work will provide robust independent research based evidence. It will aim to both inform the debate in the run-up to the referendum and assist in planning across a wide range of areas which will be affected by the outcome of the vote, whether for independence or the Union. These include voting, culture and identity, business intelligence, fiscal and monetary policy, policy development, building of new constitutional arrangements, and defence and administrative practice - particularly in public service delivery. One of the strands focuses on supporting new work at current major ESRC investments before and potentially after the vote. www.esrc.ac.uk/scotland
4. This paper is being presented at a David Hume Institute event in Edinburgh, as part of the Autumn Seminar Series, at 6pm on Monday 19 November. For further information, please contact Jeremy Peat at j.peat@davidhumeinstitute.com or on 07770 544914.



IFS hosts two ESRC
Research Centres.