

Press Release

Spending cuts or tax increases would be needed to pay for Independence White Paper giveaways

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

New calculations – based on forecasts from the Office for Budget Responsibility (OBR) – suggest that an independent Scotland would face a budget deficit of 5.5% of GDP (£8.6 billion in today's terms) in its first year of independence were it to inherit a population share of the UK's national debt. This would not be sustainable for any prolonged period. Any upside surprise on oil revenues would help, for a while, but as recent experience demonstrates, these revenues can also disappoint. And in the longer term, the eventual decline of oil revenues would likely prove a much more acute problem for an independent Scotland than it would for the UK. Thus, while independence would bring more choice about how to deliver further fiscal consolidation beyond April 2016, it is unlikely to mean that further austerity could be avoided.

The Scottish government's White Paper suggests a £400 million cut to defence spending, and the abolition of the new transferable tax allowance for married couples and the 'shares for rights' scheme. But, the spending increases and tax cuts planned or hinted at are more numerous and more costly. Implementing such a net giveaway would require bigger cuts to other public services or benefits, or increases to other taxes.

These are among the main conclusions of two new IFS reports, funded by the Economic and Social Research Council (ESRC), which update our medium-term forecasts for an independent Scotland's public finances and consider the Independence White Paper in the context of these forecasts. Other findings of the report include:

Scotland's public finances

- In 2012–13, total public spending for the benefit of Scotland was £1,257 (11.5%) per person higher than the average for the UK as a whole. Allocating a geographic share of North Sea oil and gas revenues to Scotland, total tax revenues were just £789 higher per person. Onshore revenues were £157 per person lower than the average for the UK.
- As a result, Scotland is estimated to have had a deficit 1% of GDP higher than the UK as a whole. This is a change from 2011–12 when Scotland's net fiscal deficit was smaller than for the UK. This relative decline was due to a fall in volatile North Sea revenues.
- The OBR forecasts that revenues from offshore oil and gas production will decline further over the next few years. If this turns out to be the case, Scotland's fiscal position would not strengthen as quickly as the UK's is forecast to. If the government of an independent Scotland were to implement spending cuts pencilled in by George Osborne in full it could still face a deficit of 2.9% of GDP in 2018-19, while the UK as whole is forecast to achieve a net fiscal surplus of 0.2% of GDP.
- This is a slightly weaker picture for Scotland than in our forecast earlier this year, reflecting downward revisions to the OBR's forecasts for the UK's oil and gas revenues, and to the Scottish share of these revenues.
- Scottish public finances could come in better than this if some of the oil scenarios outlined recently by the Scottish government come to pass. They would also be helped if Scotland were to inherit less than a population

Embargo

Until BST 00.01 am
Wed 4th June 2014

Contacts

Bonnie Brimstone
Institute for Fiscal Studies

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

share of outstanding debt. But these scenarios cannot be relied upon and would in any case still leave further fiscal consolidation needed not least because of the longer-term challenges of population-ageing and the eventual decline of North Sea revenues.

The Independence White Paper

- The White Paper outlined specific tax raising measures and spending cuts that would together save just under £500 million a year. On top of this there is an aspiration to raise a further £235 million through, as yet unspecified, measures to remove exemptions and reduce tax avoidance.
- The spending increases and tax cuts described in the White Paper are more numerous and more costly – around £1.2 billion a year in the short term and potentially considerably more in the longer term if full aspirations for childcare and state pensions are met (although some policies may have dynamic behavioural effects that mean that they could partly pay for themselves).
- Delaying the increase of the state pension age from 66 to 67 due to take effect between 2026 and 2028 would increase spending on the state pension and other benefits by around £550 million per year in today's terms. The fact that Scots live slightly less long on average than people in the rest of the UK does not make this more affordable. Its cost will be determined by the fraction of people reaching 66 in the late 2020s and early 2030s. At 1.3% of the population that is forecast to be slightly higher in Scotland than in the rest of the UK (1.2%),
- The biggest increase in spending is planned for childcare: £100 million per year in the first year, rising to an estimated £1.2 billion a year under longer term aspirations. This is intended to help parents of young children enter the labour market and increase their working hours. Some of the costs could be offset by increased labour supply, though there is surprisingly little strong evidence of childcare provision having a big effect on parental labour supply. The Scottish government's analysis of the policy, which includes scenarios that would entail more people entering work than there are non-working mothers directly affected by the policy, probably doesn't shed much useful light on the likely fiscal consequences.
- The White Paper rightly identifies the UK tax system as overly complex and inefficient. Its general aspirations for simplicity, transparency, and equity are admirable if uncontroversial. A number of specific policies may also make sense – a lower rate of corporation tax is likely to prove attractive to a small open economy such as an independent Scotland, for instance. But it is possible that the UK might respond by lowering its own corporate tax rate, so such competitive tax policies also carry risks.

“One thing that the Scottish Government, the UK Government and the UK opposition have in common is the lack of detail they have provided as to how they would finish the necessary fiscal repair job from April 2016. Our calculations suggest that an independent Scotland could expect to be running a deficit of around 5% of GDP in 2016–17, which would be larger than that facing the UK as a whole, and would necessitate tax rises or spending cuts.” said David Phillips, a senior research economist at the Institute for Fiscal Studies and one of the authors of the reports.

“While the White Paper contains some measures that could help balance the books, the spending *increases* and tax *cuts* pledged or hinted at are substantially larger. In a difficult fiscal context, such giveaways make the job of restoring the public finances to health more difficult, and would require bigger spending cuts or tax rises in other areas. Thus, underlying the seemingly attractive policies outlined in the White Paper are difficult, unmentioned, decisions for other public services, benefits and taxes.”

ENDS

Notes to Editors:

1. For embargoed copies of the reports or other queries, contact: Bonnie Brimstone at IFS: 020 7291 4800 / 07730 667013, bonnie_b@ifs.org.uk
2. These are the final major publications from a new IFS research programme which aims to clarify some of the fiscal choices that might face Scotland were it to become independent. They summarise and update our earlier work. 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. Earlier papers offering more comprehensive analyses of benefit spending, public service spending, taxation, and long term public finance projections for Scotland are available on the IFS website (http://www.ifs.org.uk/research_areas/99).
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. <http://www.futureukandscotland.ac.uk/>.