



The Scottish Parliament  
Pàrlamaid na h-Alba

**ECONOMY, ENERGY AND TOURISM COMMITTEE**

**AGENDA**

**18th Meeting, 2014 (Session 4)**

**Wednesday 11 June 2014**

The Committee will meet at 9.30 am in the Robert Burns Room (CR1).

1. **Scotland's Economic Future Post-2014:** The Committee will take evidence from—

Rt Hon Danny Alexander MP, Chief Secretary to the Treasury, HM Treasury, Rt Hon Alistair Carmichael MP, Secretary of State for Scotland, Scotland Office, Stephen Farrington, Deputy Director, Economics Group, HM Treasury, and Chris Flatt, Deputy Director, Constitution and Communications, Scotland Office, UK Government.

*Not before 11.20 am*

2. **Scotland's Economic Future Post-2014:** The Committee will take evidence from—

Nicola Sturgeon, Deputy First Minister and Cabinet Secretary for Infrastructure, Investment and Cities, John Swinney, Cabinet Secretary for Finance, Employment and Sustainable Growth, and Dr Gary Gillespie, Chief Economist, Office of the Chief Economic Adviser, Scottish Government.

3. **Scotland's Economic Future Post-2014- Review of evidence heard (in private):** The Committee will review the evidence heard at today's meeting.

Douglas Wands  
Clerk to the Economy, Energy and Tourism Committee  
Room T2.60  
The Scottish Parliament  
Edinburgh  
Tel: 0131 348 5207  
Email: douglas.wands@scottish.parliament.uk

The papers for this meeting are as follows—

**Agenda items 1 and 2**

Paper by the Clerk

EET/S4/14/18/1

**Economy, Energy and Tourism Committee**

**18th Meeting, 2014 (Session 4), Wednesday, 11 June 2014**

**Scotland's economic future post-2014**

**Introduction**

1. This paper provides background information for the Committee's final evidence session as part of its [inquiry into Scotland's economic future post 2014](#). There will be two separate panels of witnesses as below:

Panel 1: UK Government

- Rt. Hon. Danny Alexander MP, Chief Secretary to the Treasury
- Rt. Hon. Alistair Carmichael MP, Secretary of State for Scotland

Panel 2: Scottish Government

- Nicola Sturgeon MSP, Deputy First Minister
- John Swinney MSP, Cabinet Secretary for Finance, Employment and Sustainable Growth

2. The inquiry remit and call for evidence can be found online:

[www.scottish.parliament.uk/S4\\_EconomyEnergyandTourismCommittee/Inquiries/Economic Future Inquiry - Remit and Call for Evidence.pdf](http://www.scottish.parliament.uk/S4_EconomyEnergyandTourismCommittee/Inquiries/Economic_Future_Inquiry_-_Remit_and_Call_for_Evidence.pdf)

3. A briefing by the Financial Scrutiny Unit (FSU) is attached. The FSU has published wider briefings of relevance to the inquiry. Links to these, for information, are below:

- Scotland's economy: recent developments  
[www.scottish.parliament.uk/parliamentarybusiness/72299.aspx](http://www.scottish.parliament.uk/parliamentarybusiness/72299.aspx)
- Scotland's economy: future developments  
[www.scottish.parliament.uk/parliamentarybusiness/72297.aspx](http://www.scottish.parliament.uk/parliamentarybusiness/72297.aspx)
- The currency of an independent Scotland  
[www.scottish.parliament.uk/parliamentarybusiness/74067.aspx](http://www.scottish.parliament.uk/parliamentarybusiness/74067.aspx)

**Fergus D. Cochrane**  
**Senior Assistant Clerk to the Committee**



## Economy, Energy & Tourism Committee

### Scotland's Economic Future Post-2014: Evidence session with UK and Scottish Government Ministers

The evidence session on the 11<sup>th</sup> June offers Members an opportunity to explore issues raised in previous sessions – for example, in relation to currency, Scotland's public finances, welfare and inequality – with the UK and Scottish Government Ministers. As such, this briefing re-issues relevant information from publications by the Scottish Government, the UK Government and academics as well as summarising relevant evidence received by the Committee during its inquiry so far. Annex 1 also provides a summary of the recent UK Government and Scottish Government publications in relation to the outlook for public finances in an independent Scotland.

#### Currency

##### *Scottish Government and UK Government positions*

Both the Fiscal Commission Working Group (FCWG) and the Scottish Government are in agreement that, given the economic integration between Scotland and the rest of the UK, an independent Scotland would wish to continue to use Sterling in a formal monetary union. However, the Chancellor of the Exchequer, George Osborne, delivered a [speech in Edinburgh on Thursday 13<sup>th</sup> February 2014](#) where he appeared to rule out a formal monetary union between an independent Scotland and the rest of the UK. Chief Secretary to the Treasury, the Rt Hon Danny Alexander MP reiterated to the Committee “our analysis suggests that a currency union simply would not be acceptable from the rest of the UK's perspective” ([Official Report](#) 19 Feb 2014 – col 3939). However, the Cabinet Secretary for Finance, Employment and Sustainable Growth John Swinney told the Committee that he believes the UK Government's position would change in the event of a Yes vote, stating:

*“there are compelling reasons why the UK Government will agree to a sterling zone after a successful yes vote in the referendum. We have rehearsed a number of them. There is the contribution of Scotland to the balance of payments. There are the transaction costs that businesses south of the border would have to pay if Scotland was not operating in a sterling zone. There is the cost to the UK Government of additional debt servicing.”* ([Official Report](#) 19 Feb 2014 - col 3986).

The UK Government responded by writing to the Committee to explain that transaction costs are not the only consideration when assessing a currency union, stating that the dangers of a currency union are elsewhere: “They are about the way

in which risks are transmitted” ([Letter from Chief Secretary to the Treasury](#) dated 8 May 2014)<sup>1</sup>.

#### *Expert’s views on the currency options*

The Committee has heard a range of views on which currency option would or should actually be taken forward in an independent Scotland. For example, Crawford Beveridge, the Chair of the FCWG, believes that a monetary union with rUK is inevitable, stating “the economics will trump the politics, and good heads will prevail if there happens to be a yes vote. We therefore would not want even to talk about a plan B at this stage of the game” ([Official Report](#) 5 March 2014 – col 4105). On the other hand, Dr Angus Armstrong of the National Institute of Economic and Social Research (NIESR) is a proponent of an independent Scotland having its own currency. He told Committee: “Based on the desire that is expressed in the white paper to build a Scotland that reflects the values and aspirations of the Scottish people, you would want something that provided the policy levers that enabled you to do that. In my view, there is only one option that allows that full range, and that is your own currency” ([Official Report](#) 5 March 2014 – col 4075). Professor Ronald MacDonald agreed, stating to Committee that “Nothing else will work; nothing else will be credible to markets” ([Official Report](#) 12 March 2014 - col 4149).

However, Dr Armstrong also told the Finance Committee that dollarization – where an independent Scotland would continue to use the pound in an informal currency union – seems to be the “converging position” on currency ([Official Report](#) 30 April 2014 – col 4027). In recent research he goes on to state “Whether the outcome provides a stable currency regime for an independent Scotland is another question entirely. As we have seen, when using the currency of another country with a high debt burden governments may also need a lender of last resort” ([2014](#)). Unless some form of cross border liquidity insurance is in place, he argues that “dollarization would in all likelihood transform Scotland’s financial system. Many institutions would change their domicile” ([2014](#)).

#### *Currency negotiations and Scotland’s share of the national debt*

*Scotland’s Future* gives two methods by which Scotland’s share of debt might be calculated: apportionment by reference to the historic fiscal balance of public spending and taxation since 1980/81 (the earliest year for which figures are available) or a population share. Under either method an independent Scotland would have a debt to GDP ratio smaller than the rest of the UK’s ([2013](#)).

However, Deputy First Minister and Cabinet Secretary for Infrastructure, Investment and Cities Nicola Sturgeon warned “if we do not have a share of the assets, by definition, we cannot be expected to take on a share of the debt.” ([Official Report](#) 19 February 2014 – col 3961) with Cabinet Secretary for Finance, Employment and Sustainable Growth John Swinney explaining “the logic of the Treasury’s position means that the Treasury is walking into the payment of an extra £4 billion to £5.5 billion a year in debt interest charges to sustain an extra amount of up to £130 billion of debt” ([Official Report](#) 19 February – col 3967).

---

<sup>1</sup> Note – in this letter the UK Government estimated that transactions costs for Scottish businesses would increase by £600 million if an independent Scotland used a different currency to the pound.

Dr Monique Ebell of NIESR had some concerns regarding the impact of this stating to Committee “Scotland not servicing or not repaying its share of the debt would set a rather dangerous precedent and might not be looked on very kindly by some other countries.” ([Official Report](#) 12 March 2014 – col 4170). The Chief Secretary to the Treasury, Danny Alexander MP highlighted an estimate by Jefferies investment bank that a default scenario would result in a sovereign debt premium of 500 basis points which “assuming a 75 per cent pass-through from bond rates to mortgage rates, would mean an extra cost of about £5,200 on the average mortgage in Scotland” ([Official Report](#) 19 February 2014 – col 3926). However, Professor Andrew Hughes Hallett told Committee that the impacts of default are “overblown” and explained, “I would not get too worried. It is not that the point is wrong; it is just that you can overemphasise it” ([Official Report](#) 5 March 2014 – col 4118).

### *Currency and borrowing costs*

The currency arrangement is one of the factors that will likely influence the cost of borrowing faced by an independent Scottish Government. Although Standard & Poor’s have stated that the macroeconomic profile of the wealthy and open Scottish economy conforms with the typical profile of sovereigns rated in investment-grade categories (i.e., 'BBB-' or higher), they state that “a decision by a sovereign Scotland to issue its own new and untested currency or to unilaterally adopt the currency of another sovereign - without gaining access to that currency's lender of last resort - could pose some initial risks to external financing, in our opinion” (2014<sup>2</sup>). Speaking to the Finance Committee, Dr Armstrong stated:

*“Under a formal monetary union, with a shared central bank, we estimate a spread of 72 to 165, with the central point being 120 basis points. Those estimates remain, under that model. If you do not have that model, and you have an informal currency union with no shared central bank, the spread of interest rates is likely to be higher”* ([Official Report](#) 30 April 2014 – col 4025).

Dr Ebell explained that under dollarization banks may have to have much higher capital ratios “that would put a brake on Scottish banks’ ability to lend to Scottish businesses and facilitate their growth” ([Official Report](#) 12 March 2014 – col 4162).

### **Scotland’s public finances**

The most recent Government and Expenditure Revenue Scotland publication ([2014](#)) showed that Scotland had a fiscal deficit equivalent to 8.3% of GDP in 2012-13 including a geographical share of North Sea revenues. This compares to a fiscal deficit of 7.3% of GDP at the UK level. In *Scotland’s Future* the Scottish Government forecasts that Scotland’s deficit will fall to between 2.5 per cent and 3.2 per cent of GDP in 2016/17 if Scotland takes on a population share of UK public sector debt. However, the Scottish Government does “recognise that, as with any financial projection, revenues and expenditure may be higher or lower than projected at this stage” ([2013](#)).

Giving evidence to the Committee, Paul Johnson of the Institute of Fiscal Studies (IFS) stated “were Scotland to become independent in 2016, there would remain a

---

<sup>2</sup> Standard & Poor’s Ratings Services: Key Considerations For Rating An Independent Scotland published 27 February 2014

significant deficit, which would need to be addressed at some point” ([Official Report](#) 5 March 2014 – col 4070). He spoke about two key constraints that an independent Scottish Government would face: demographic change (an ageing population will put additional strain on public finances) and the tax base and how it will develop (e.g., corporation tax is on a downward trend and there is uncertainty from oil revenues). And he stated that the level of debt that an independent Scotland starts off with would also have a big impact, explaining, “There would be significant benefits to walking away with no debt. I suspect that how that came about would be what would determine whether there were any additional, negative consequences in terms of credibility” ([Official Report](#) 5 March 2014 – col 4070). He suggested that an oil-for-debt swap could be an extremely creative and potential beneficial policy to alleviate debt explaining “You would have a bigger economy that would be more able to cope with volatility by swapping volatility for some of the debt that a small economy would find it difficult to live with” ([Official Report](#) 5 March 2015 – col 4089).

Professor Jeremy Peat added that an independent Scotland “would, at least initially, have to run a tight fiscal policy in order to prove its credibility to the financial markets” ([Official Report](#) 12 March 2014 – col 4164). He also highlighted the challenge of establishing an oil fund given constraints in public finance:

*“Given the volatility and uncertainty of oil revenues, it makes sense to establish some form of oil fund, but to do so when one is starting with quite tight public finances is difficult and will take time. The more money one squirrels away for later, the less one has to spend now.”* ([Official Report](#) 12 March 2014 – col 4165)

## Taxation

The Fiscal Commission Working Group published their report [Principles for a Modern and Efficient Tax System in an Independent Scotland](#) (2013) suggesting that independence offers an opportunity to re-examine the tax system and design one that is more robust and efficient following the principles of simplicity, neutrality, stability and flexibility. Paul Johnson of the IFS suggested that Scotland has already made some improvements to the tax system with regard to devolved taxes. He stated: “We start from a fairly sub-optimal tax system in the UK and in Scotland that could be made more efficient in a number of ways. One or two changes have been made in Scotland that have improved elements of the tax system” ([Official Report](#) 5 March 2015 - col 4077). However, when it comes to radical improvements under independence, he told the Committee “The real question is whether the political and other pressures on an independent Scotland in developing its tax system would be noticeably different from those that apply to the Westminster Government and which have, as you described, resulted in a complex system” ([Official Report](#) 5 March 2015 – col 4083). Elspeth Orcharton of the Institute of Chartered Accountants of Scotland (ICAS) spoke of similar concerns when giving evidence to Committee: “... although there might be a great wish to do something, it can be difficult in practice to make the decisions and negotiate the play-offs” ([Official Report](#) 19 March 2014 – col 4196).

In the event of independent, the Scottish Government proposes a transitional period during which the current functions of HMRC are continued in Scotland and the rest of the UK on a shared services basis. Furthermore, it proposes that a new tax system is developed for Scotland with initial improvements in place within the period of the



first independent Parliament. When asked about the timescale for setting up a new system Elspeth Orcharton stated that her estimate “is that the process would take nearer 10 years than four, or perhaps somewhere in the middle” ([Official Report](#) 12 March 2014 – col 4200).

Although detailed policies on tax and spending under independence would be set out in party manifestos for the 2016 election, the Scottish Government states in *Scotland’s Future* that “there is no requirement to increase taxes to pay for the services we currently enjoy in Scotland”. It also highlights six priorities, including:

- Increasing personal allowance and tax credits by inflation,
- Ending UK Government proposals for tax allowances for some married couples,
- Examining the case for increasing National Insurance employment allowance for small businesses,
- Designing a more efficient tax system with a target revenue gain of £250 million,
- Reducing Air Passenger Duty by 50 per cent, and
- Reducing corporation tax by up to three percentage points ([2013](#)).

A number of witnesses raised specific concerns in relation to the proposal to reduce corporation tax. For example, Moira Kelly of the Chartered Institute of Taxation (CIOT) stated:

*“One of our fears is that that might lead to a race to the bottom in which corporation tax in tax jurisdictions goes down and down. Squaring that with an approach of achieving various things with welfare benefits in Scotland might be an issue.”* ([Official Report](#) 12 March 2014 – col 4186)

Other witnesses spoke of their concerns as to how the corporation tax proposal would be funded with Michael Clancy of the Law Society of Scotland explaining to Committee that “A lowering of corporation tax might mean that the gap would have to be filled by an increase in tax in other areas” ([Official Report](#) 12 March 2014 – col 4189).

Witnesses also discussed the potential for Scotland to use increased tax powers to reduce inequality. Professor Andrew Hughes Hallett argued “Redistribution is a hell of a lot easier if a country has its own tax system and is not locked into somebody else’s” ([Official Report](#) 5 March 2014 – col 4110). However, Professor David Bell had a different view, explaining that his research showed “although one can fiddle about with the tax and benefits system to some extent, inequality in Scotland and the UK is such that movements in tax and benefits are unlikely to bring down inequality levels substantially” ([Official Report](#) 5 March 2014 – col 4132).

## Oil and gas

### *Forecast tax receipts in 2016*

The *Scotland’s Future* white paper uses oil and gas tax forecasts originally published by the [Scottish Government in March 2013](#). These range from £6.8 billion to £7.9 billion for 2016/17 (the first year of independence), and are based on various production scenarios and a projection of 2011 and 2012 average oil prices. Recent



[Office for Budget Responsibility \(OBR\) forecasts](#), which assume DECC production estimates and prices implied by futures markets data, estimate total UK oil and gas revenues in 2016/17 of £3.2 billion, less than half the Scottish Government's estimate.

#### *Decommissioning tax relief*

The 2013 UK Budget saw the introduction of Decommissioning Relief Deeds; contracts between the UK Treasury and oil companies guaranteeing that future governments will pay decommissioning relief at 2013 levels. The *Scotland's Future* white paper also commits to providing decommissioning relief 'in the manner and at the rate currently provided through the current fiscal regime'. In his [written evidence to the Committee](#), Professor Kemp highlights the "complex situation...when decommissioning takes place after Scottish independence but the claw back extends to the pre-independence date". Relief of between 50% to 75%, on total decommissioning costs of up to £45 billion, will have a significant financial impact on any future government, and will be subject to negotiations in event of a 'yes' vote.

#### *Transition considerations*

The Committee heard concerns about the length of time it would take to establish an oil and gas fiscal and regulatory regime in a newly independent Scotland. Professor Alex Kemp and lawyer Penelope Warne both agreed that the 18-month timescale, as proposed by the Scottish Government, would be "quite challenging". According to Ms Warne, over 13,000 treaties would require renegotiating by a Scottish civil service which currently does not include much oil and gas tax and licensing expertise ([Official Report](#) 28 May 2014 - col 4414). *Scotland's Future* recognises the "premium" oil and gas companies place on operating under a stable and predictable tax regime. Professor Kemp therefore highlighted the importance of ensuring fiscal and regulatory certainty over the 18 month transition period.

### **Economic policy**

#### *Industrial strategy*

The industrial strategy set out in the *Scotland's Future* white paper includes support for investment, support for indigenous companies and ownership, bringing together employment and skills policies, targeted use of loan guarantees and expanding our manufacturing base. A number of witnesses raised some concerns about this. For example, Stephen Boyd, STUC, told the committee "... our concern is that some of the things that we believe would have to change in order to make industrial policy more effective and to rebalance manufacturing's share of the economy are not even mentioned." ([Official Report](#) 2 April 2014 - col 4277). Robin McAlpine of the Jimmy Reid Foundation agreed, explaining to the Committee "The key is to have a much more mixed and diverse economy, by size, type and ownership, and part of that is collective ownership of industries that can be used more effectively collectively than simply by contracting private companies." ([Official Report](#) 2 April 2014 - col 4282).

#### *Regulation*

The *Scotland's Future* white paper sets out proposed actions to streamline competition and regulation policy. In particular it proposes a combined regulatory body on competition and consumer issues. The white paper also states an independent Scotland will establish its own financial regulator.

While Colin Borland of the Federation of Small Businesses explained that "... the biggest regulator for many small businesses is the local authority or licensing board." ([Official Report](#) 2 April 2014 – col 4254), other witnesses suggested that there may be challenges associated with regulatory changes under independence. Iain McMillan, CBI Scotland, stated to the Committee that "... two jurisdictions would have to be paid for and complied with. There is a risk around that." ([Official Report](#) 2 April 2014 – col 4243).

Sir John Gieve, University College London, outlined the risks of a new regulatory environment with specific reference to the financial sector, explaining "First, there is the powerful consideration that they would be dealing with a regulator that they already know ... so it would be no small thing to switch to a new, unknown regulator. Secondly, the regulator that regulates them at the moment has quite a powerful voice in international financial rule making." He suggested that this, along with other factors, might give some businesses in the sector concerns about keeping their main headquarters in Scotland ([Official Report](#) 12 March 2014 - col 4161).

#### *Views on risks and opportunities*

The Scotland's Future white paper states that 'Scotland's economic performance is now stronger than – or just as good as – the UK on key measures'. This was echoed by Danny Alexander, who told the Committee that outside London, Scotland is the 'most successful part of the United Kingdom economically in terms of growth, employment and attractiveness for foreign direct investment' as well as higher output per head than Denmark, Finland and Portugal. He went on to say that "All those things show the strength of Scotland's economic performance" ([Official Report](#) 19 February 2014 - col 3924-5).

Ian McKay, Institute of Directors Scotland, summarised the risks and opportunities associated with independence by telling the committee "Like any major change, it offers both, and I think that most businesses will come to it in that way" ([Official Report](#) 2 April 2014 - col 4240). Iain McMillan (CBI Scotland) cited the most significant risks associated with independence as "the fiscal position of an independent Scotland; the currency that an independent Scotland may or may not use; EU membership; and the fragmentation of the current internal UK market" ([Official Report](#) April 2014 - col 4241). Owen Kelly, Scottish Financial Enterprise, cited further risks associated with independence "include the terms on which European Union membership would be based. Currency is also a major area of uncertainty" "... the market for financial services would, in effect, become two markets. There would need to be separate taxation in a Scotland that was no longer part of the United Kingdom, and there would have to be separate financial regulation" ([Official Report](#) April 2014 - col 4244). He added "It is difficult, at this stage, to know how long the transition period would be between a yes vote and a steady state." and cited opportunities for SFE members "... particularly those in investment banking, if you are talking about creating a new currency and placing bonds in the market and suchlike." ([Official Report](#) April 2014 - col 4244).

In addressing opportunities associated with independence Garry Clark, Scottish Chambers of Commerce, suggested "I think that we would support a more streamlined and simplified tax system. Independence could provide that; equally, it could be provided within the existing structures in the UK." ([Official Report](#) April 2014 - col 4275). Robin McAlpine, Jimmy Reid Foundation, further highlighted "We barely

talk about corporate governance, but it is one of the big opportunities for us to improve the economy. To again use Germany as an example, one third of the board of directors of Volkswagen is elected from among its workers.”([Official Report](#) April 2014 - col 4293).

### *Labour market*

The *Scotland's Future* white paper states that well-rewarded and sustained employment is the best way to tackle poverty and inequality. The white paper outlines an increase in the minimum wage, commitment to the living wage, more employee representation on company boards, greater gender balance on boards and the establishment of a National Convention on Employment and Labour Relations.

One of the labour market concerns discussed during evidence sessions was the participation of women in the workforce. Professor Mike Danson, Heriot-Watt University, stated “The Scottish economy has a major structural problem. One of the ways in which that manifests itself is through a gross underutilisation of women, particularly of their skills and experience. The availability of childcare will lead to a much better opportunity to employ them productively in higher-wage, higher-value-added jobs” ([Official Report](#) 2 April 2014 – col 4289). However, Stephen Boyd of STUC highlighted the implications of Nordic-style labour market policies, stating “ ... we must be clear that, if we want to create public services akin to those in the Nordic nations, that will involve taxation taking a much higher proportion of GDP ([Official Report](#) 2 April 2014 – col 4280).

## **Welfare and inequality**

### *Social Partnership model*

Central to the Scottish Government’s vision of a more equal economy is the adoption of a ‘social partnership’ model in the labour market. Referencing OECD research linking trade union membership to lower levels of income inequality, the Scottish Government proposes to ‘formalise the relationship between government, employer associations and employee associations’. Key to this will be the establishment of a National Convention on Employment and Labour Relations, ‘a forum which encourages direct and constructive dialogue across all key stakeholders’.<sup>3</sup>

The Scottish Government is keen to see more employee representation on company boards (as is common in Germany and some Scandinavian countries) as well as greater gender balance on boards, concluding that ‘an independent Scotland can examine innovative ways to support improvements in the productivity and well-being of the workforce’. The STUC ‘generally supports’ the White Paper’s partnership approach, going on to argue that ‘the current separation of powers between employment services and health and education as well as from wider powers on employment and trade union rights is a limiting factor in the promotion of effective labour market policy’(STUC, [A Just Scotland](#), 2013).

Asked why our Nordic neighbours have lower levels of inequality than those seen in Scotland, Dr Mary Hilson of University College London told the Committee that this is partly a result of strong social democratic policies introduced during the mid-20<sup>th</sup>

---

<sup>3</sup> P 104 to 105 White Paper

Century. However, such policies were introduced into societies which were already more egalitarian than their Anglo-Saxon neighbours ([Official Report](#), 7<sup>th</sup> May 2014 – Col 4474). The STUC's Stephen Boyd also accepts that 'a set of societal factors exist in the Nordic nations which enable social partnership to flourish...these conditions do not currently apply in Scotland' ([presentation to the Royal Society of Edinburgh](#), 2013).

#### *Drivers of inequality*

David Eiser's written submission to the Committee shows that inequality in Scotland is slightly lower than the UK as a whole and almost exactly the same as the UK rate once London is excluded. Inequality levels in Scotland are significantly higher than those seen across Scandinavia. The ten countries with the lowest levels of inequality in the OECD are small (10 million population or less) northern and central European countries. Meanwhile, according to the Scottish Government, Scotland is 'locked in to one of the most unequal economic models in the developed world'<sup>4</sup>. However, Oxfam's Dr Katherine Trebeck pointed out that 'over the past 20 or 30 years, inequalities have got worse across the developed world' ([Official Report](#), 23<sup>rd</sup> April 2014 – Col 4318).

Modelling a range of potential tax and welfare policies in an independent Scotland, David Eiser concludes that raising tax and out of work benefits would have only limited impacts on inequality levels. The major driver of income inequality is *pre-tax* incomes, primarily caused by the continued polarisation of the UK labour market. David Eiser and his colleague at Stirling University, Professor David Bell, conclude that 'given that many of the drivers of inequality are linked to global trends in technology, and family formation practices, there are likely to be limits to the extent that a small open economy can mitigate them. Scottish independence would provide opportunities, but it would also come with constraints' ([Inequality in Scotland](#), 2014).

Morag Gillespie of Caledonian University pointed out that when discussing inequality 'we focus much less on the exponential growth in high wages'. With this in mind, Dr Katherine Trebeck suggested that a maximum wage or earnings ratio could help to tackle income inequality ([Official Report](#), 23<sup>rd</sup> April 2014 – Col 4340 and 4328).

#### *Nordic welfare and taxation*

In her [written submission to the Committee](#), Dr Mary Hilson defines what is commonly referred to as the 'Nordic welfare model', highlighting extensive and generous welfare states, with the state the dominant provider of comprehensive services, and benefits linked to citizenship rather than labour market status. Fellow witness, Professor Michael Keating, also stressed the importance of 'social investment', whereby 'public expenditure is seen to contribute not only to economic growth, but to social equality'. He highlighted the importance of childcare and early years policies 'which encourages social mobility for all the people who have fallen out of the job market'.

Professor Keating in response to questions about the costs associated with Nordic welfare systems, mentioned higher levels of VAT (with fewer exemptions than in the UK) and higher levels of income taxes:

---

<sup>4</sup> P. 5 White Paper

*'Taxes would have to be higher (should Scotland adopt a Nordic welfare system). There is no doubt about that. The model is costly, but people in the Nordic countries are generally willing to pay those taxes because they appreciate what they get back from them and because, if there are universal services, everybody feels that they get something back from them. I do not see the Scottish Government's white paper facing up to that, but that is the implication of the model. It is very costly ([Official Report](#), 7<sup>th</sup> May 2014 - Col. 4478).'*

Dr Mary Hilson, during the same session, questioned Professor Keating's assumption that Scandinavians happily acquiesce in paying high levels of tax:

*'Since the 1970s in particular, we have seen the emergence of the anti-tax, anti-bureaucracy, anti-big-state parties—the populist right, which is now on the rise across Europe, especially in Norway ... The high-tax model is not universally accepted, by any stretch of the imagination' ([Official Report](#), 7<sup>th</sup> May 2014 - Col. 4478).*

**Scherie Nicol, Greig Liddell and Richard Marsh**  
**SPICe Research**  
**6 June 2014**

Note: Committee briefing papers are provided by SPICe for the use of Scottish Parliament committees and clerking staff. They provide focused information or respond to specific questions or areas of interest to committees and are not intended to offer comprehensive coverage of a subject area.

## Annex 1 - Outlook for public finances in an independent Scotland

Both the Scottish Government and the UK Government released analysis of the outlook for public finances in an independent Scotland on 28 May 2014. This short note provides an overview of the claims being made by each

### *UK Government claims*

The UK Government's [Scotland analysis: Fiscal policy and sustainability](#) outlines its fiscal projections and concludes that additional cuts to public services equivalent to £1,400 per person would be needed each year from 2016-17 to close the gap in public finances of an independent Scotland, relative to the UK, by 2035-36. The UK Government thus concludes that the "UK Dividend" from staying part of the UK is equivalent to leaving each Scottish person £1,400 a year better off from 2016-17 onwards. The components of the UK Dividend are shown in Table 1 below:

**Table 1 – Components of the UK Dividend each year from 2016-17 onwards (in 2016-17 prices)**

Component	Amount per head (£)	Total (£bn)
Higher public spending in Scotland	981	5.2
Set-up costs and net fiscal effects of White Paper policies avoided (corporation tax cut, air passenger duty cut and childcare policy)	261	1.4
Lower Scottish onshore tax revenues absorbed across UK	207	1.1
Cost of ageing absorbed across the UK	163	0.9
Long-term oil decline absorbed across the UK	130	0.7
Lower UK borrowing costs	47	0.3
Oil revenues shared across UK, rather than geographically	-389	-2.1
<b>Total UK Dividend</b>	<b>1,400</b>	<b>7.5</b>

Source: The Guardian [2014](#) and SPICe calculations

### *Scottish Government claims*

The Scottish Government's [Outlook for Scotland's public finances and the opportunities of independence](#) shows how the long-run fiscal outlook for an independent Scotland might look given changes to Scotland's economic performance reflected in:

- A 0.3 percentage point increase in Scotland's annual productivity growth (in addition to 2.2% baseline productivity growth)
- A 3.3 percentage point increase in Scotland's employment rate
- A 6.2% increase in the Scottish population (the ONS high migration variant population projection for Scotland)

The analysis models an improvement in one or all of these drivers of economic growth rather than a specific policy between 2018-19 and 2029-30. If these improvements in economic performance were all achieved, it is estimated that Scottish onshore revenues would increase by over £5 billion a year by 2029-30



relative to the baseline. This is equivalent to additional onshore revenues of around £1,000 per head in an independent Scotland with improved economic performance. The components are shown in Table 2 below:

**Table 2 – Components of the boost to onshore tax revenues in 2029-30 under independence (in 2012-13 prices)**

Component	Amount per head (£)	Total (£bn)
Higher productivity growth	450	2.4
Increased employment	250	1.3
Higher population growth	300	1.5
<b>Total boost to tax revenues</b>	<b>1,000</b>	<b>&gt;5.0</b>

Source: SPICe calculations (rounded to nearest 50)

#### *Commentary on the claims*

A number of economists have commented on the claims made by both the UK Government and the Scottish Government. Angus Armstrong of the National Institute for Economic and Social Research highlights that each report seeks to answer a different question and this makes it difficult to compare the claims (2014). David Eiser highlights that the reports do not even agree on Scotland's fiscal position in 2016, with differences driven largely by assumptions on North Sea revenues as well as the size of the debt burden that Scotland would inherit. David Bell highlights that the UK Government has used the latest oil revenue forecast produced by the OBR while the Scottish Government has used its own projection of revenues that assumes no significant change in the oil price but does envisage a small increase in production. He stated that while no-one knows which forecast will be correct, past OBR forecasts of oil revenues have tended to be optimistic relative to the outcome (2014). Gemma Tetlow of the IFS comments that the different methods serve to highlight how much more sensitive Scotland's fiscal position would be to fluctuations in this source of revenues than is the UK as a whole (2014). Beyond 2016 the differences amplify due to different assumptions on borrowing costs and the inclusion of the costs of independence by the UK Government but the benefits of improved economic performance by the Scottish Government. David Eiser states:

*“The Treasury report confirms that Scotland will face long-term challenges in respect of population ageing and declining oil revenues, and that the fiscal policies proposed to-date are unlikely in themselves to address those issues. But the Scottish Government report reminds us that independence does bring opportunities as well as threats.” (2014)*

The UK Government's estimate of the cost of setting up new institutions under independence has received considerable attention. Professor Patrick Dunleavy complained that the UK Government “woefully misapplied” his research estimates to derive the estimate (2014). Robert Young commented that “estimates of transaction costs vary, in part because the future is unknowable and in part because politicians deploy estimates to affect voters” (2014).

The Scottish Government's work has also received attention because it relies on changes to Scotland's economic performance. David Eiser raised his concern that “there is no attempt to explain how particular policies or interventions will generate



these outcomes, beyond general statements” and Gemma Tetlow stated “whilst it may turn out to be the case that the Scottish economy does a great deal better after independence than it would as part of the UK, planning on this as a central assumption seems less than cautious” ([2014](#)).