QUICK NOTE

A briefing note from The Jimmy Reid Foundation

IFS REPORT ON SCOTLAND

As with so many economic reports, the IFS report into the finances of an independent Scotland (published November 2012) has provoked mixed reactions. Some, like Alistair Darling and the Better Together campaign, have voiced concern about the reliance of Scotland on North Sea oil and gas. The Yes campaign has jumped on the findings that Scotland has performed better than the UK in a number of periods between 2000 and now.

Not coming out for or against independence, as such, the report simply makes two things clear. Firstly, Scotland does have slightly higher public spending per capita, despite very similar household incomes, than the UK as a whole and on-shore GDP i.e. excluding North Sea production, of 98 per cent of the UK's. Second, in the short to medium term, these can be more than offset by the revenue from North Sea oil and gas, assuming a geographical allocation of the revenues. Indeed, according to the authors such an allocation:

> "increases Scotland's GDP by 22 per cent to £27,732 per capita, which was 117 per cent of the UK level"; and

> "On this basis, expenditure as a share of GDP looked similar in Scotland and the UK throughout the 1990s and 2000s."; and

> "Higher oil prices in recent years mean that, since 2007–08, allocation of a geographical share of North Sea output leads to expenditure being a slightly lower fraction of GDP than in the UK as a whole."; and

> "Where Scotland receives a geographical share of north Sea revenues, its fiscal position looked much stronger than that of the UK in 2008-09, fairly similar in 2009-10 and rather stronger again in 2010-11. Without the oil revenues, the Scottish fiscal situation would have looked substantially worse even than the UK's own rather grim situation."

As for the long term, the report simply maintains that the declining oil and gas resources (although, of course, there are conflicting reports about when, if, and how severely these declines will occur) mean that, since an independent Scotland would depend on these resources for 15 per cent of its national income, it would have to wean itself off this into a more mixed economy.

There are different aspects to the oil and gas question. The first regards the volatility of this stream of income. As the authors point out:

> "They accounted for 21 per cent of Scottish revenues in 2008-09 and 12 per cent just a year later...Over a longer period, they have varied between a low of three per cent of revenues in 1991-91 and high of 48 per cent in 1984-85."

On it's own, price volatility is not a death-sentence. What is of greater concern is the long-term decline in reserves. While the study does quote the Office of Budget Responsibility's projection that revenues from oil and gas production will fall over 80 per cent between 2011-12 and 2022-23. The problem with this estimate is that no one really knows. Indeed, while production peaked in 1999, and 40 billion barrels have been extracted since the 1970s, the industry body Oil and Gas UK estimates that between 15 and 24 billion barrels remain, taking production well in the 2040s. New sites are still being discovered – although the rate is not necessarily consistent – and a recent round of investment broke previous records for applications for licenses. What's more, depletion of stocks is a double-edged phenomenon, as depleting stocks increase prices, making more extraction economically viable, and so on.

What the report makes clear, and appears lost on some of the more reactionary responses to the report is that balancing the books in the long-term is the crucial issue. Not even the most ardent believers in the oil and gas industry could or would maintain it being the sole pillar of an economic independent Scotland. Even if this idea of Caledonian oil sheikdom was feasible, it certainly doesn't correspond with what anyone in Scotland would consider appropriate, wise, or environmentally sustainable.

When considering long-term prospects, the report turns more to questions than answers, and rightly so. That the decisions may be starker in Scotland than elsewhere is understandable, this shouldn't surprise the many on the left who have argued that under-development of Scotland's economy and lack of attention to it's specific economic needs is part of our economic problems. As a result the report assumes that the economic growth rates of Scotland and the UK will remain as they are projected for the UK and does not consider the future impact of expanding Scottish industries such as renewable energy or a more expansionary policy framework.

Another key question the report raises would regard Scotland's borrowing power in international financial markets. The Bank of England has relatively low borrowing costs, and, as the authors note:

> "If Scotland is to make the transition to independence, finding ways to minimise the costs of servicing [the] substantial debt burden will be crucial."

The discussion of fiscal debt raises a host of issues. Certainly, there is every reason to believe that moving away from Westminster's approach to public sector debt would reap dividends, but the precise balancing of this and possibly long term implications and which currency would be used are unanswered question. Also, there is little reason to believe that current policies will produce a lower ratio of public sector debt by 2014. Indeed the report notes that on UK Government forecasts:

> "accumulated national debt will be over 76 per cent of national income in 2014–15 and still over 74 per cent in 2016–17. It will not fall back to pre-crisis levels for a generation. "

There is also the possibility that Alex Salmond is too accurate in his damning appraisal of the UK political situation. Given the 'double-dip' that occurred between Q4 of 2011 and Q2 in 2012, and the fact that the Coalition financial approach will likely make the situation worse by 2014, there will likely be more debt than necessary to divide. This is scorched earth politics, and it might have a considerable impact. However, as important as the actual numbers would be the response of an independent Scottish government. Cameron et al's response has been, as we all know, a slash-and-burn response, marked by both ideology and a centrally-pushed myth regarding the risks and impending crisis of 'reckless government spending'. Indeed, as esteemed economist Paul Krugman has spent years maintaining, the current UK approach to debt is both unnecessary and counter-productive. Crucially, it is not the only option.

Certainly, this report will not be the last word on the economics of independence. There are, however, two things to note in conclusion. First, the debate about Scottish independence, from a political perspective, is principally an economic one. This is not in the sense that people's aspirations are principally economic, but only that their fears are. Agreement about cultural specificity, historically distinct institutions and an 'indigenous egalitarianism' are irrelevant if people feel they would be voting for a drop in living standards. This was made clear in the 2011 ScotCen Social Attitudes Survey, which found that two thirds would vote against independence if they were £500 a year worse off, with 65 per cent voting the opposite way if the situation was reversed. While 47 per cent were found to back independence with little or no change, it's fair to bet that neither side of the debate will be canvassing on the basis that independence will make zero difference.

The second observation is that, for all the bluster, the report's conclusions are rather mild. Simply put, Scotland's position is, at least in the short-run, rather tenable. While the dependence on oil and gas is certainly not an ideal situation, this makes the debate about how the economy could be sufficiently diversified and made sustainable, rather than if an independent Scotland is even possible.

The IFS report is available from:
www.ifs.org.uk/bns/bn135.pdf