# Scotland's Fiscal Balance position:
# Better or worse off under Independence than as part of the UK?

**August 2014**

**John McLaren**
**Jo Armstrong**

**AP/2014/001**

# SCOTLAND’S FISCAL BALANCE POSITION: BETTER OR WORSE OFF UNDER INDEPENDENCE THAN AS PART OF THE UK?

## EXECUTIVE SUMMARY

The principal aim of this Analysis Paper is to clarify what is known about Scotland’s Fiscal Balance position and to highlight the likely range of what remains uncertain.

In late May, both Scottish and UK governments issued their final documents on this subject. To help untangle the various claims made, our analysis looks at two key time frames; the fiscal position at the point of independence, assumed to be 2016-17, and the longer term position that might emerge, 15 to 20 years hence.

## SCOTLAND’S FISCAL BALANCE, 2016-17

The Fiscal Balance is the difference between the money spent by a government (ie, total public expenditure) and the money raised by that government, mainly through taxes (ie, total revenues).

### Scottish onshore primary balance

The onshore primary balance for Scotland consists of the balance between its onshore revenues and its non-debt related expenditures. These two elements dominate the Fiscal Balance and, in 2012-13, accounted for 90% of total revenues and 94% of total expenditure.

For 2016-17, both independent and Scottish government forecasts of these two elements display little in the way of variation. This results in a common estimate for Scotland’s onshore primary balance of around -£6 billion.

### Scotland’s offshore revenues and debt related payments

In contrast to the main revenue and expenditure elements, there is considerable uncertainty over the size of the two smaller key components of Scotland’s overall Fiscal Balance, which are North Sea tax revenues and debt interest payments.

The paper illustrates two possible ranges for these components, where the upper and lower bounds in each case are consistent with various estimates made by the Scottish government or the UK government in their published material.

This results in:

- a **Narrow Range** for North Sea tax revenues of between £2.8 billion and £4.7 billion and for debt related expenditure of between £3.9 billion and £5.5 billion; and,

- a **Wide Range** for North Sea tax revenues of between £1.2 billion and £7.8 billion and for debt related expenditure of between £0.0 billion and £6.1 billion.

### Scotland’s Fiscal Balance

Applying the narrow and wide ranges of North Sea revenue and debt expenditure estimates to the -£6 billion onshore primary balance results in a Fiscal Balance for Scotland that remains in deficit across the full ‘best’ to ‘worst’ positions of the narrow range, from between -£5.1 to -£8.6 billion.

Applying the wider range of estimates results in a small surplus of £1.9 billion being generated when the most beneficial outcomes for Scotland apply, but an even higher deficit of -£10.8 billion when applying the least beneficial outcomes.

**An independent Scotland's Fiscal Balance relative to being part of the UK**

Contrasting Scotland's Fiscal Balance under independence with its position when remaining within the UK is often done by showing the balance in terms of £ per head of population, although it needs to be remembered that any such figures do not apply to individual Scots but to the Budget available to the Scottish government.

Using this criterion, Scotland is seen to be relatively worse off than the UK across the full breadth of the narrow range, by the equivalent of between -£266 and -£916 per person, while across the wide range, its relative position shifts from better off (+£1,033), to being even worse off (-£1,324) relative to the UK.

## SCOTLAND'S FISCAL BALANCE IN THE LONGER TERM

The Scottish and UK government's most recent Fiscal Balance publications both looked into the more distant future in order to come up with estimates of how much better off (Scottish government) or worse off (UK government) Scots would be post-independence.

The **Scottish government claimed** that by 2029-30, Scots would be the equivalent of **£1,000 better off** (in 2012-13 prices**)** per person, as a consequence of independence.

The **UK government claimed** that Scots would be an average of **£1,400 worse off** (in 2016-17 prices) per person, as a consequence of independence, every year between 2016-17 and 2035-36.

What explains the extremity of these differences in Scotland's long term position?

First, the Scottish government is not claiming that, by 2029-30, the Fiscal Balance for Scotland will be relatively lower than the UK's. Instead its claim, based on its own long term assumptions, is that the onshore Scottish economy will grow faster than it would otherwise, and that this would increase government revenues by the equivalent of £1,000 per person.

Second, that the UK government is claiming that Scotland's Fiscal Balance will be relatively worse than the UK's, and by a considerable amount. However, this is based on a specific cost/benefit outcome for a series of future revenue and expenditure items, whereas in reality there is a wide range of potential outcomes for each of these outcomes.

## IN CONCLUSION

We cannot be certain of Scotland's future Fiscal Balance, even in the short term, due to uncertainties over elements like North Sea revenues and debt expenditure.

Estimates consistent with the range of assumptions in the Scottish government's White Paper and with the UK government's central assumptions suggest that, in 2016-17 Scotland would have a higher relative fiscal deficit than the UK.

Looking at a broader range of possible outcomes for key revenue and expenditure items, again as proposed by the Scottish and UK government's, shows that Scotland could potentially be in a better or an even a worse position by 2016-17.

An example of where the tipping point between better and worse off comes would be if the Scottish government negotiated a debt payments share no more than half of its population share <u>and</u> North Sea tax revenues were at a level that is almost double the OBR's central estimate.

Longer term projections for Scotland's fiscal and economic outlook are even more difficult to call, exacerbated by increasing uncertainty over time and the compounding impact of even small variations in assumptions over time.

## INTRODUCTION

This Analysis Paper aims to clarify, as far as is possible, what is known about Scotland's Fiscal Balance position and to highlight the likely range of what remains uncertain.

There has been much in the way of claim and counterclaim by the Scottish and UK governments over the degree to which Scotland would have a better or worse Fiscal Balance as a result of independence.

In late May, both governments issued their final documents on this subject, making it possible to reassess the figures and the main areas of agreement and disagreement. To help untangle the various claims made, our analysis looks at two key time frames; the fiscal position at the point of independence, assumed to be 2016-17 and which is covered in Section 1, and the longer term position that might emerge, 15 to 20 years hence, and which is covered in Section 2.

As we shall see, there is no definitive figure for how much better or worse off Scotland would be because of the high degree of uncertainty in key areas. However, this paper highlights the likely range within which the outcome will fall.

### What is a country's Fiscal Balance and why is it important?

The Fiscal Balance is the difference between the money spent by a government (ie, total public expenditure) and the money raised by that government, mainly through taxes (ie, total revenues).

If revenues fall short of expenditures then there is a deficit, which is the position that both Scotland and the UK currently find themselves facing (equally if revenues exceed spending then there is a surplus). If there is a shortfall between money spent and money raised, this is closed by government borrowing and if there is a surplus, this can be used to reduce debt.

There are two important aspects to the Fiscal Balance:

- the first is the size of any one year's fiscal surplus or deficit; and,
- the second is the cumulative impact of surpluses and deficits, as seen in a country's overall debt position.

Having a deficit and being in debt is not unusual (such a position applies for most EU countries), but if the deficit becomes large and is recurring, then debt also starts to rise, to potentially unsustainable levels, as happened in many OECD countries following the 2008 financial crisis.

As national debt rises it tends to lead to higher debt interest payments; annual costs that cover both the interest on the debt as well as any scheduled debt repayments. Paying more to service such debt inevitably means that less of the government's revenues are available to spend directly on public services such as health and education.

While this Analysis Paper concentrates on the overall Fiscal Balance, many governments set targets with regards to the current Fiscal Balance, which excludes government spending on investment. This is on the grounds that such investment can increase future potential growth and so may result in higher output and revenues. However, international comparisons usually concentrate on the overall Fiscal Balance, and we follow that lead here.

The Analysis Paper looks at the relative fiscal position of Scotland, both as an independent country and when continuing to remain within the UK.

Whether Scotland remains as part of the UK or becomes independent, it is still in the process of adjusting its public sector spending (as is the UK) to more closely match its anticipated revenues[1].

---

[1] Scotland as part of the UK has to manage its spending plans in line with UK government limits.

Such rebalancing is deemed essential by both governments, in order to maintain credibility with the debt and capital markets so that additional borrowing will continue to be made available at affordable rates of interest. Where the two governments currently disagree is over the pace and composition of such on-going austerity.

## SECTION 1: SCOTLAND'S FISCAL BALANCE IN 2016-17

### Fiscal Balance key components

To understand both the similarities and differences underpinning the Scottish and UK governments' values for Scotland's Fiscal Balance, it is necessary to look at the values ascribed to the underlying key components, as shown in Box 1.

**Box 1**

| **Key components of Scotland's Fiscal Balance, including the latest (2012-13) GERS estimates** | |
|---|---|
| REVENUES | Onshore Revenues of £47.5 billion |
| | Offshore (North Sea) Revenues; Scotland's share which was £5.5 billion |
| EXPENDITURE | Non debt related expenditure of £61 billion |
| | Debt related expenditure of £4 billion |
| FISCAL BALANCE | £12 billion in Deficit |

*Source: Government Expenditure and Revenue Statement (GERS), 2014*

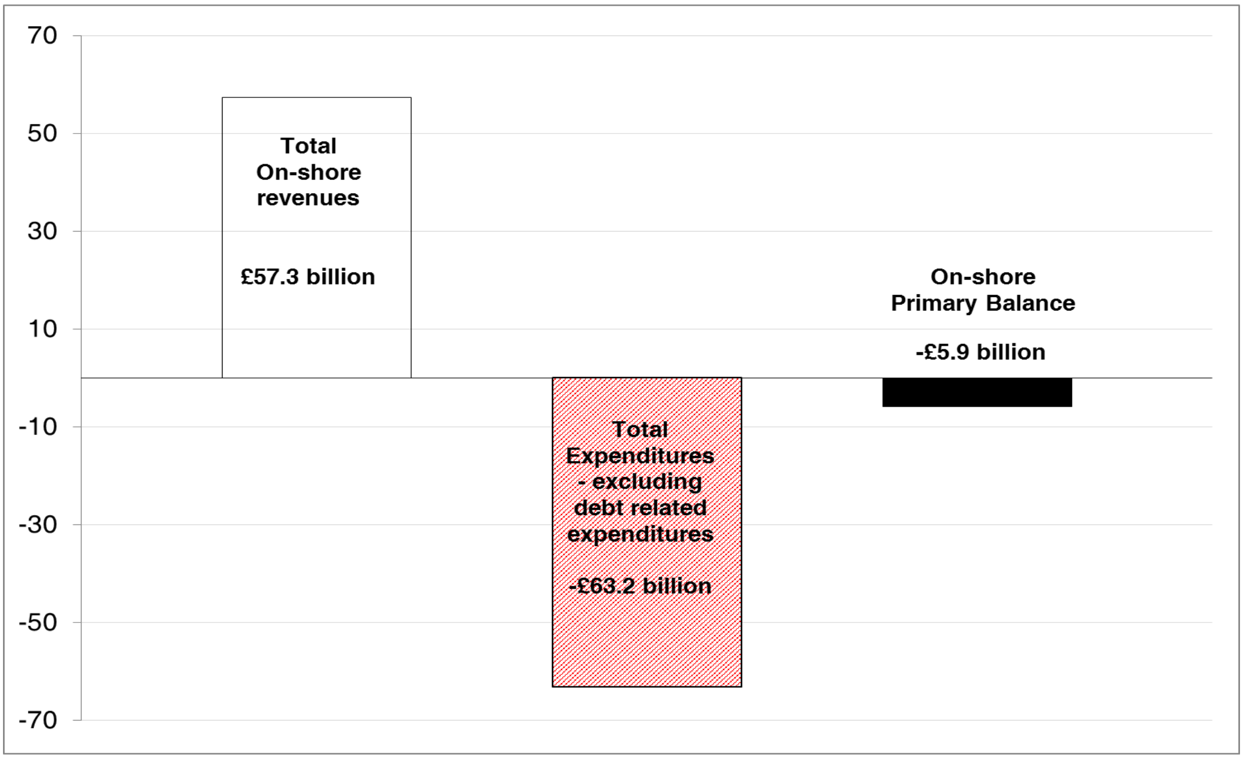
*Note: data rounded to nearest £0.5 billion.*

### Scotland's onshore primary balance

The **onshore primary balance f**or Scotland consists of the balance between its onshore revenues and its non-debt related expenditure (ie, it excludes North Sea revenues and debt related expenditure), see Figure 1.

In 2012-13, these two elements accounted for 90% of total revenues and for 94% of total expenditures. Independent and Scottish government forecasts of these two elements for 2016-17 display little in the way of variation. For example, Figure 1 shows the projections taken from the latest estimate by the Scottish government (May 2014). This results in a -£5.9 billion onshore primary balance, which is very similar to that calculated at the time of the White Paper, -£6.8 billion (November 2013), and to the latest Centre for Public Policy for Regions estimate, -£6.7 billion.

**Figure 1: Scotland's projected Onshore Primary Balance in 2016-17, £ billion (cash terms)**




*Source: Scottish government (May 2014)*

At -£5.9 billion, this onshore primary deficit is projected to be lower than the latest GERS' estimate for 2012-13 of -£13.5 billion (ie, the £47.5 billion of on-shore revenues less £61 billion oil non-debt expenditures from Box 1). This projected improvement in Scotland's Fiscal Balance is a direct result of the Scottish government continuing to implement the spending cuts and austerity measures inherent in the UK government's existing budget measures.

**Scotland's offshore revenues and debt related expenditure**

In contrast to the main revenue and expenditure elements, there is considerable uncertainty over the size of the two smaller key components of Scotland's total Fiscal Balance, namely, North Sea tax revenues and debt related expenditure.

This is because (i) North Sea revenues are highly dependent on future price and production levels, which are unpredictable and largely out of the control of any government and (ii) because debt related expenditure will depend on future negotiations between the two governments on what share of the UK's debt an independent Scotland would inherit.

To highlight the importance of these two components, and to show the range of values that each government is claiming as plausible, we illustrate two possible ranges for both (i) North Sea revenues and (ii) Scotland's share of UK debt, namely:

- A **narrow range**, which has a lower bound consistent with the UK government and the Office for Budget Responsibility's (March 2014) central assumptions and an upper bound consistent with the more optimistic assumptions used in the Scottish government's White Paper.

- A **wide range**, which has a lower bound consistent with the UK government's (May 2014) and the OBR's (July 2014) more pessimistic estimates, and an upper bound consistent with the more optimistic assumptions used in the Scottish government's latest publication on an independent Scotland's fiscal position (May 2014).

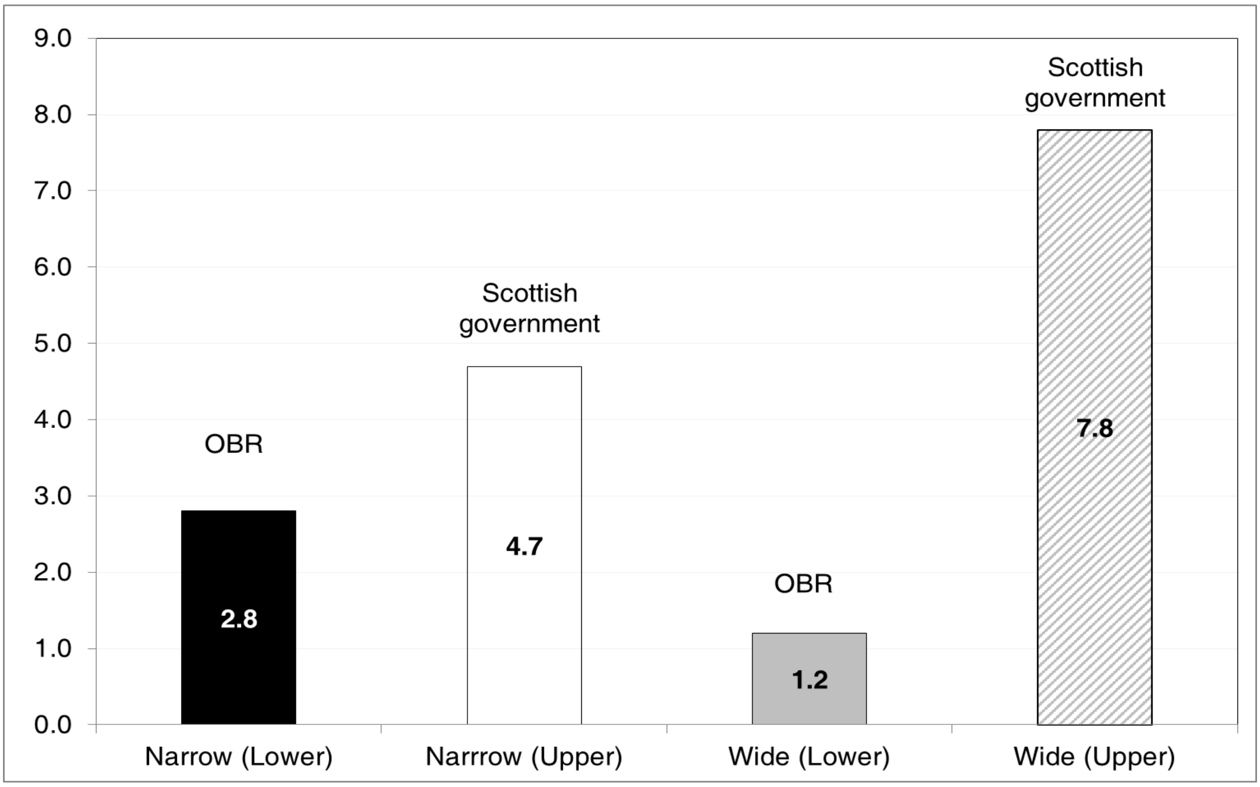
(i) Scottish North Sea revenues (2016-17)

Based on the sources described, the narrow and wide ranges for potential North Sea revenues due to Scotland in 2016-17 are as follows (see also Figure 2):

**Narrow Range:** lies between a lower value of £2.8 billion[2] and an upper value of £4.7 billion.

**Wide Range:** lies between a lower value of £1.2 billion and an upper value of £7.8 billion.

**Figure 2: Projected range for Scottish North Sea tax revenues in 2016-17**
**£ billion (cash terms)**




*Sources:*

***Narrow range**: lower value (£2.8 billion) - in line with the Scottish share of the Office of Budget Responsibility's (OBR) latest (March 2014) central estimate (based on 87%, ie, the average over the last 5 years of the Kemp & Stephens and HMRC estimated Scottish geographical shares) and the Scottish government's Scenario 1 estimate (which was slightly higher at £2.9 billion as it assumes a 90% geographical share) from its latest set of projections (May 2014)); upper value (£4.7 billion) - the Scottish government's Scenario 2 projections (May 2014). Note: this Scenario is the closest to the assumptions (though not the same as) at the upper end of the North Sea oil revenues range used, for illustrative purposes, in the White Paper.*

***Wide range**: lower value (£1.2 billion) - a Scottish share (87%) of the OBR's low price scenario (based on the US Energy Information Administration, EIA, 'low oil price' scenario), as published in its latest Fiscal Sustainability Report (July 2014); upper value (£7.8 billion) - the Scottish government's Scenario 6 projections (May 2014).*

It is worth noting that the UK government's range (as taken from OBR forecasts) on this issue is much narrower than the Scottish government's. While the UK's government's extends from £1.2 billion to 4.4 billion[3], the Scottish government's range extends from £2.9 billion to 7.8 billion.

[2] All projections are in cash terms unless otherwise stated.
[3] The latter figure is not shown above but is equivalent to the OBR's high price scenario in its latest Fiscal Sustainability Report.

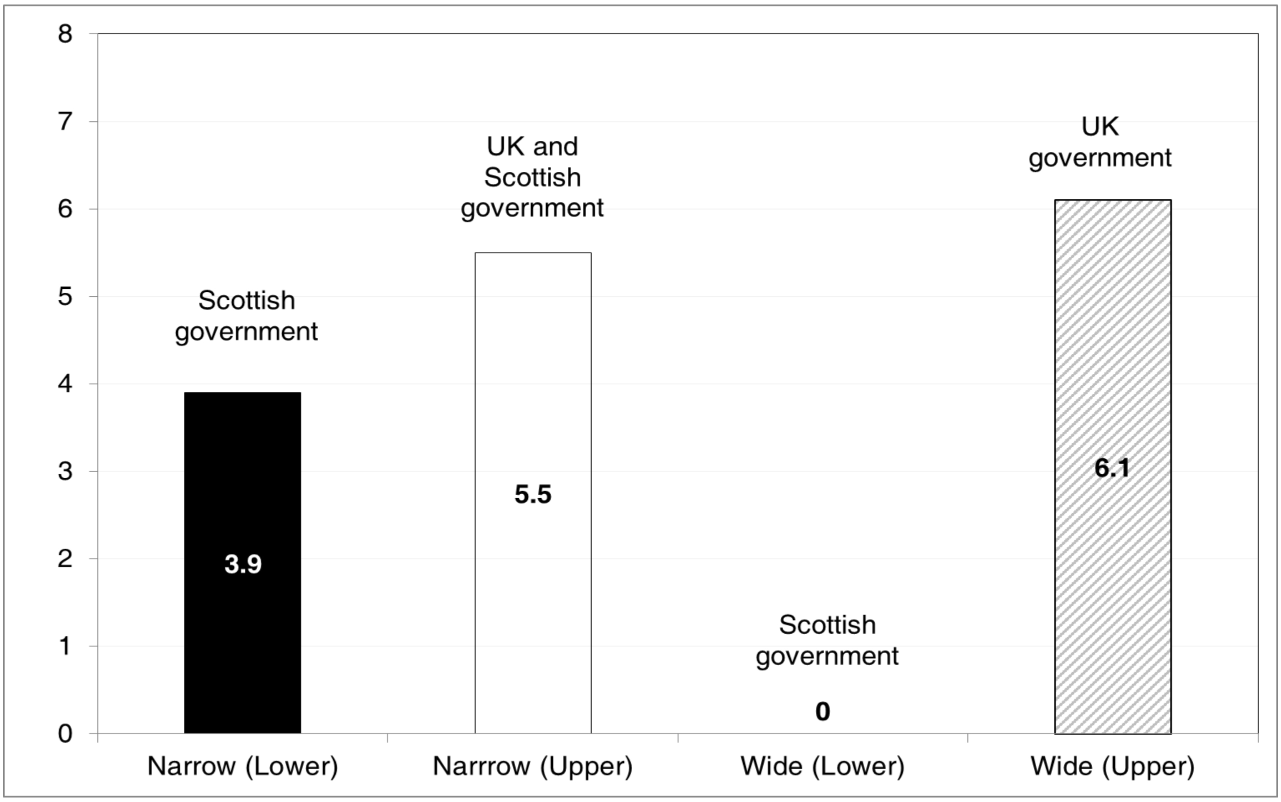
(ii) Scottish debt related expenditure (2016-17)

Again, based on the sources described, the narrow and wide ranges for potential debt related expenditures liable to be paid by the Scottish government in 2016-17 are as follows (see Figure 3):

**Narrow Range:** lies between a lower value of £3.9 billion and an upper value of £5.5 billion.

**Wide Range:** lies between a lower value of zero and an upper value of £6.1 billion.

**Figure 3: Projected range for Scottish debt related expenditure in 2016-17**
**£ billion (cash terms)**




*Sources:*

***Narrow range**: lower value (£3.9 billion) - the Scottish governments 'historic share' value used in the White Paper (November 2013); upper value (£5.5 billion) - Scotland's population share estimate that is used by both the UK government (May 2014) and the Scottish government from its top of the range estimate in the White Paper.*

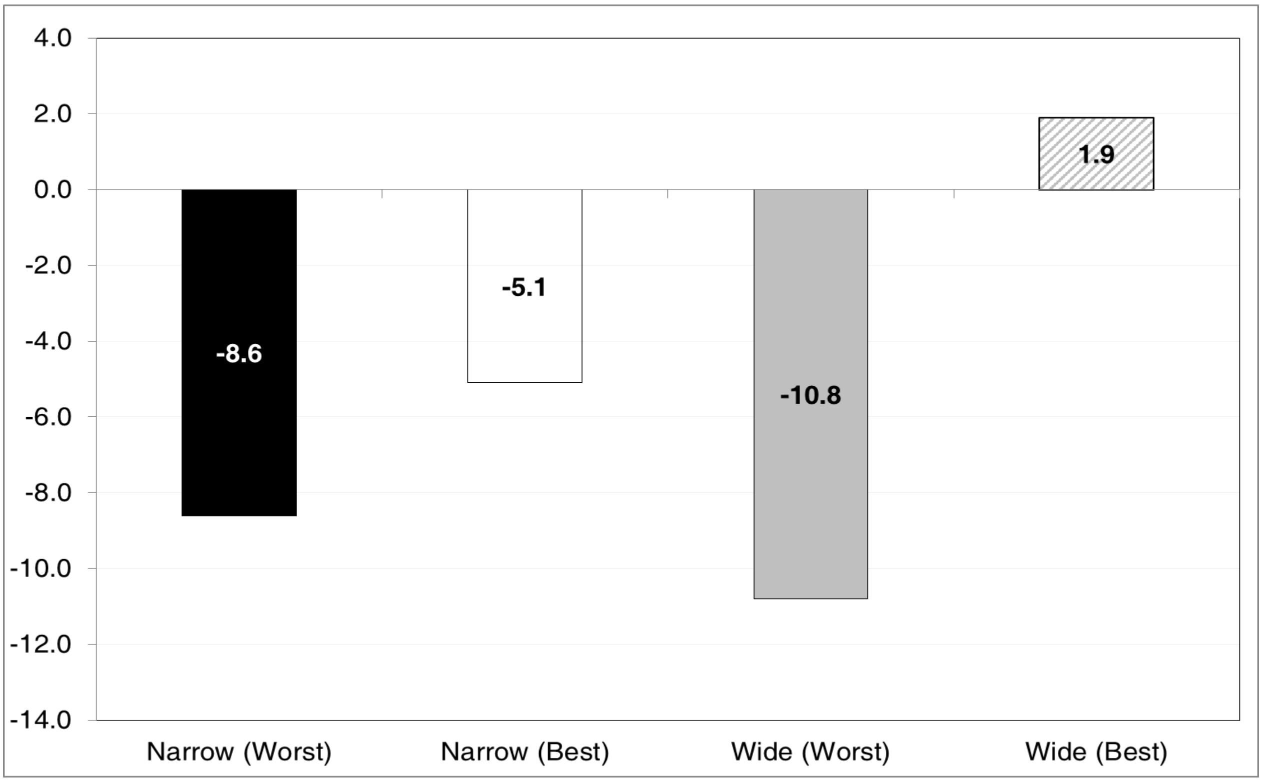
***Wide range**: lower value* (zero) *- in line with a lower bound estimate used in the Scottish government's report 'Outlook for Scotland's Public Finances and the Opportunities of Independence' (May 2014); upper value (£6.1) - Scotland's GDP share estimate as used by the UK government in the recent HM Treasury publication (May 2014).*

It is again worth noting that the UK government's range is quite narrow, extending from £5.5 billion to 6.1 billion. In contrast, the Scottish government's range is much broader, extending from £3.9 billion to 5.5 billion in the White Paper and from zero to £5.5 billion in its latest estimate (May 2014).

**Scotland's overall Fiscal Balance**

Adjusting the point estimate derived earlier for Scotland's onshore primary balance (shown in Figure 1) by applying the narrow and wide range estimates for both North Sea revenues and debt related expenditure results in a range for Scotland's overall Fiscal Balance (see Figure 4).

**Figure 4: Scotland's overall Fiscal Balance in 2016-17, £ billion (cash terms)**




*Sources: as shown in Figures 1, 2 and 3*

Applying the **narrow range** of estimates results in Scotland's Fiscal Balance remaining in deficit across the full 'best' to 'worst' positions range, from between -£5.1 billion to -£8.6 billion (ie, -3% to -5% of Scotland's Gross Domestic Product (GDP)).

Applying the **wider range** of estimates results in a small surplus being generated in 2016-17 of £1.9 billion (ie, +1.1% of Scotland's GDP), when the most beneficial outcomes for Scotland apply (ie, £7.8 billion of North Sea tax revenues and zero debt related expenditure).

However, applying the least beneficial values (ie, £6.1 billion of debt related expenditure and £1.2 billion of North Sea tax revenues) results in Scotland having an even higher deficit for 2016-17, now up to -£10.8 billion (ie, -6.4% of Scotland's GDP)[4].

**An independent Scotland's Fiscal Balance relative to being part of the UK**

Contrasting Scotland's Fiscal Balance under independence with its position when remaining within the UK is often done by showing the balance in terms of £ per head of population, although it needs to be remembered that any such figures do not apply to individual Scots but to the Budget available to the Scottish government (see Table 1).

[4] To put these figures into a little more perspective, the latest GERS data, for 2012-13, shows Scotland with a deficit of -£12 billion (ie, -8.3% of Scotland's GDP).

**Table 1: Fiscal Balance, 2016-17, £ per person**

| | Scotland<br>Narrow range | Scotland<br>Wide range | UK* |
|---|---|---|---|
| Fiscal balance per person | -946 to -1,596 | +353 to -2,004 | -680 |
| Scotland relative to UK | -266 to -916 | +1,033 to -1,324 | - |

*Sources: as Figure 4, ONS, GROS*

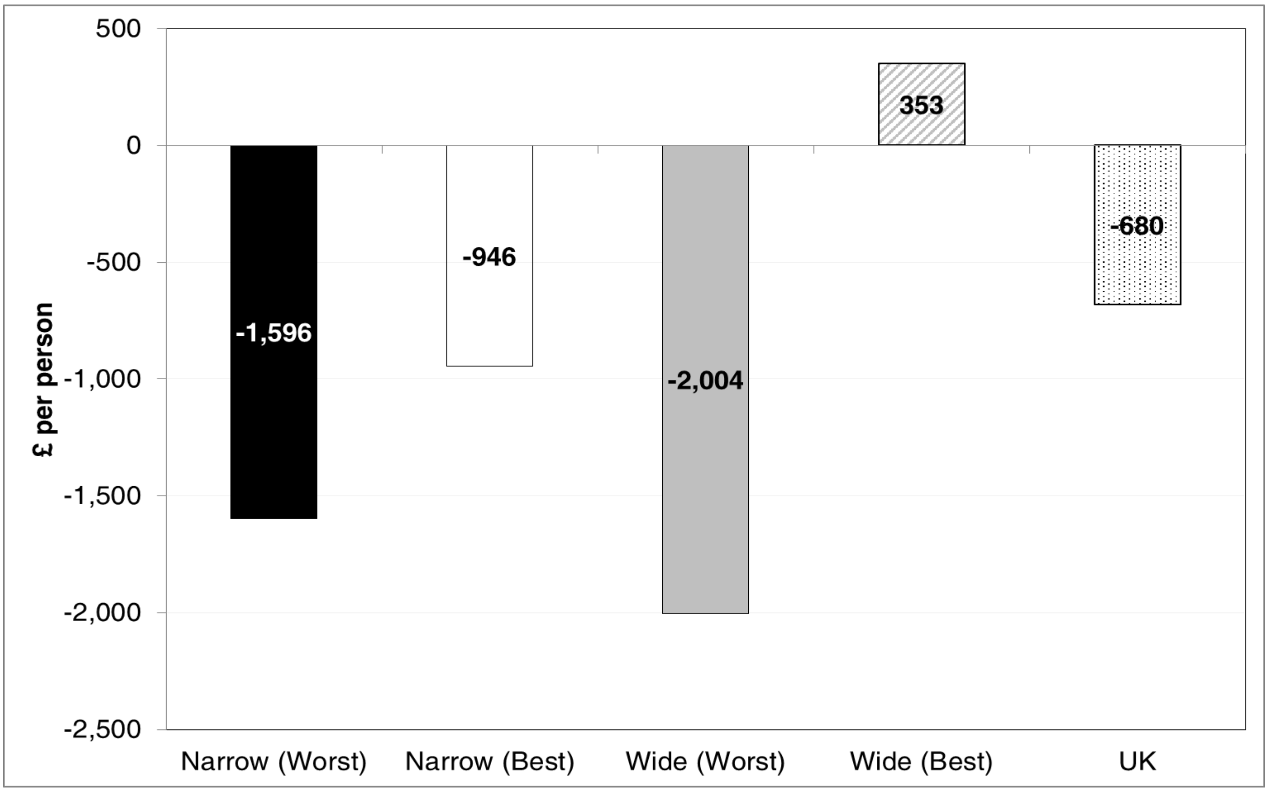
** The UK estimate is based on the latest OBR estimate for the UK. For presentational purposes, it does not take into account the impact that the ranges of North Sea oil for Scotland would have if applied to the UK. Equally, the implications for the rest of the UK's Fiscal Balance of different assumptions over Scotland's share of debt related expenditure are also not shown.*

Using this criterion, Scotland is seen to be relatively worse off than the UK across the full breadth of the **narrow range** of results, by the equivalent of between -£266 and -£916 per person.

Across the **wide range**, Scotland's position shifts from better off (+£1,033), when applying the most beneficial outcomes to Scotland for both debt related expenditure and North Sea tax revenues, to being further in the red (-£1,324) relative to the UK[5].

An example of where the tipping point between better and worse off comes would be if the Scottish government negotiated a debt payment's share no more than half of its population share and North Sea tax revenues at a level that is almost double the OBR's central estimate.

**Figure 5: Scottish & UK Fiscal Balances in 2016-17, £ per person**




*Source: as Table 1*

[5] Putting these figures into perspective, the latest GERS data, for 2012-13, shows Scotland to be relatively worse off than the UK by the equivalent of -£470 per person.

It is important to be clear what any relatively higher or lower fiscal deficit means. If Scotland has a smaller fiscal deficit than the UK, then to move to the same relative position, Scotland would be able to cut taxes or raise spending. Equally, if Scotland had a bigger fiscal deficit per person than the UK, then to move to the same relative position as the UK, Scotland would have to raise taxes or cut spending.

## SECTION 2: SCOTLAND'S FISCAL BALANCE IN THE LONGER TERM

While the position at the potential point of independence is of interest, of even greater interest is how that position might change over time.

The Scottish and UK governments most recent Fiscal Balance publications both looked into the more distant future in order to come up with estimates of how much better off (Scottish government) or worse off (UK government) Scots would be post-independence (see Box 2).

**Box 2**

| **UK and Scottish governments' claims** | |
|---|---|
| Scottish government | By 2029-30, Scots would be the equivalent of around £1,000 **better off** per person (in 2012-13 prices**)** as a consequence of independence |
| The UK government | Scots would be **worse off** under independence by an average of £1,400 per person (in 2016-17 prices), every year between 2016-17 and 2035-36 |

### Understanding the Scottish government's long term claim

The Scottish government is arguing that, under certain assumptions (as shown in Table 2), the onshore tax revenues being generated within Scotland would be around £5 billion higher, the equivalent of £1,000 per person, by 2029-30 than would otherwise be the case (ie, relative to the outlook currently assumed for Scotland remaining within the UK). It should be noted that the Scottish government describes this analysis as "an illustration" of what might happen. The UK Government's counter assumptions are also shown in Table 2.

What the Scottish government's analysis is not saying is that Scotland's Fiscal Balance would be relatively better or worse than if it were still part of the UK by that date. This is because the Scottish government does not look at all revenues and expenditure this far out. In particular, the Scottish government makes no long term projections of offshore revenues or of the expenditure side.

This is an important point as the contribution to the Fiscal Balance by 2029-30 of the offshore sector is likely to have fallen, as all commentators (including OBR, DECC, Oil & Gas UK, Kemp & Stephens) believe that North Sea production is on a long term declining path.

Furthermore, while each of the Scottish government's long term projected economic and social outcomes is possible, their achievement is not straightforward. Success depends on the Scottish government being able to increase the growth of the economy either by achieving higher productivity or increasing employment. In each case, governments around the world are seeking to make similar such improvements but there is no agreed process by which they can be delivered.

**Table 2: Longer term assumptions underpinning the Scottish government's onshore revenue projections, £ (2012-13 prices)**

| | Scottish government assumptions | Impact by 2029-30 £bn (cash) | UK government alternative assumptions | Impact by 2029-30 £bn (cash) | Comment |
|---|---|---|---|---|---|
| Scotland's productivity growth rate | An increase of 0.3 of a percentage point, to 2.5% | 2.4 | 2.2% | n/a | 1998-2007 average for Scotland of 2.1%. |
| Scotland's employment rate | An improvement of 3.3 percentage points, to 74.3% | 1.3 | 71% | n/a | Latest LFS estimate at 73.4%. Target reached in 2007 and 2008. |
| Scotland's population growth rate | ONS high migration variant assumption | 1.5 | ONS principal migration assumption | n/a | |

*Sources: 'Scotland analysis: Fiscal policy and sustainability', HM Treasury, May 2014; 'Outlook for Scotland's Public Finances and the Opportunities of Independence', Scottish government, May 2014; 'Scottish Government State of the Economy', April 2014; ONS database; GROS database*

## Understanding the UK government's long term claim

In the case of the UK government, their estimate that Scotland would be £1,400 per person per year worse off has been derived from a comparison of the Fiscal Balance of an independent Scotland to that of the UK. This has been done by averaging the impacts of a number of different components on the Fiscal Balance over a 20 year period, as shown in Table 3.

Key assumptions related to these elements include: borrowing costs in an independent Scotland (related both to historic as well as projected new debt); the costs of setting up a separate government and all its institutional organisations and arrangements (although these turn out to be very small relative to the total); the White Paper policy costings, etc. As a result, while each of these outcomes is possible, equally, there exist a wide range of alternative outcomes based on alternative assumptions.

Again, ideally, we would compare these assumptions with the Scottish government's counter assumptions. However, while it is possible to make some such comparisons, there is no complete set of alternative long term assumptions available. Where available these are shown in Table 3.

**Table 3: Longer term assumptions underpinning the UK government's revenue and expenditure projections, £ (2016-17 prices)**

| | UK government* assumptions | Impact £ pp | Scottish government alternative assumptions | Impact £ pp** |
|---|---|---|---|---|
| Higher oil revenues at point of independence | Scotland retains 80% of North Sea tax revenues | 389 | Scotland retains 90% of higher estimate of North Sea tax revenues | ? |
| Lower public expenditure at point of independence | Scotland loses extra funding per head that it currently receives | -981 | Scotland loses extra funding per head that it currently receives | ? |
| Lower onshore revenues at point of independence | Scotland has lower onshore tax revenue per head | -207 | See Table 2 | ? |
| Long term oil revenues decline | In line with OBR 2013 long term projections | -130 | Alternative scenarios assume higher revenues profile compared to current OBR projections | ? |
| Higher long term costs of ageing | Scotland's demographics worse | -163 | Higher migration improves demographics | ? |
| Set up costs | £1.5 billion estimate | -4 | £200 million | -1 |
| Net cost of policies in the White Paper | Starting at £1 billion in 2016-17 | -257 | No net (short term) cost | 0 |
| Extra borrowing costs | 1.2 percentage points above UK level | -47 | No difference to UK level | 0 |
| Total | | -1,400 | | ? |

*Sources: 'Scotland analysis: Fiscal policy and sustainability', HM Treasury, May 2014; 'Outlook for Scotland's Public Finances and the Opportunities of Independence', Scottish government, May 2014.*

** These assumptions do not adjust for all the potential negative impacts highlighted in the Treasury's series of papers on the impacts of independence. For example, Treasury have not included any trade barriers impact in its calculation, even though these were estimated to be, potentially, very large in the long run in its 'Scotland Analysis: Macroeconomic and fiscal performance' paper.*

*** It is not possible to give the Scottish government's estimates in each of the categories shown as it has not made long term projections for these elements.*

### The importance of the Barnett Formula in Scotland's future Fiscal Balance

One further issue that could impact on Scotland's future finances, at least as part of the UK, is any revisions to the Barnett formula.

While the UK government has said it has no plans to change the formula that currently provides Scotland with its annual block grant allocation of funds, there are two provisos to this position.

- First, the Barnett formula will have to change regardless, in order to accommodate the Scotland Bill 2012 powers and possibly further devolution of fiscal powers.

- Second, the long term position discussed above looks out over a twenty year horizon and no UK government is able or willing to give a commitment that far out.

This could be an important issue as it would have a material impact on Scotland's longer term fiscal position, if it remains within the UK. However, it is difficult to make any judgments at this stage as to how any such changes to the Barnett formula may affect the figures in the long term as:

- the Barnett formula currently only applies to year-on-year changes in the budgets covered, which tend to be small, relative to the size of the annual block grant as a whole;

- the formula is already constructed in a way that is intended to bring about a degree of convergence between the spending per head in Scotland and that seen in the UK, and any 'faster' convergence is unlikely to come about through a one-off cut but rather through an alternative form of 'adjustment'.

**Longer term Fiscal Balance projections**

There are some important points to take away from this analysis of the long term impacts, which were little discussed at the time of publication.

- First, the Scottish government is not claiming that, by 2029-30, the Fiscal Balance will be better than that seen for the UK as a whole. Instead its claim, based on its own long term assumptions, is that the onshore Scottish economy and related government revenues will grow faster than they would otherwise, and than they have experienced over recent decades.

- Second, the UK government is claiming that Scotland's Fiscal Balance will be relatively worse than the UK's, and by a considerable amount. However, this is based on a set of specific estimates for a series of future revenue and expenditure items, whereas in reality there is a wide range of potential outcomes for each of these items.

- Third, neither the Scottish nor the UK government has estimated a longer term Fiscal Balance for Scotland that lends itself to making the sort of specific calculations seen for 2016-17 in Section 1.

The publication of longer term forecasts such as these is useful in the sense that they highlight possible outcomes. However, their usefulness is tempered by the fact that there are a host of alternative possible outcomes. This is because much, currently unknown, can happen over a 15 to 20 year period.

As well as the assumptions highlighted in Tables 2 and 3, the future Fiscal Balance of an independent Scotland will also be influenced by factors not fully covered in either government's analysis. Most pressing of these are likely to be the policies needed to deal with the fiscal impact from rising health and age-related demographic costs. So too will be the externally driven impact from how issues such as global warming concerns impacts on renewable energy prices or how the political situation in the Middle East evolves and impacts on oil prices.

## CONCLUSIONS

- We cannot be certain of Scotland's future Fiscal Balance, even in the short term, due to uncertainties over elements like North Sea oil and gas related revenues and debt related expenditure.

- Estimates consistent with the range of assumptions used by the Scottish government in its White Paper and with the UK government's central assumptions, suggest that, in 2016-17 an independent Scotland would have a higher relative fiscal deficit than the UK.

- Looking at a broader range of possible outcomes for key revenue and expenditure items, again as proposed by the Scottish and UK governments, Scotland could potentially be either better off or be even worse off, in relative terms than the UK in 2016-17.

- An example of where the tipping point between better and worse off comes would be if the Scottish government negotiated a debt payments share that is only 50% of its population share and North Sea tax revenues were at a level that is almost double the OBR's central estimate.

- Not surprisingly, given these short-term variations, longer term projections for Scotland's fiscal and economic outlook are even more difficult to call, exacerbated by increasing uncertainty and the compounding impact of even small changes in assumptions over time.

- Thus far, the Scottish and UK governments have not presented long-term future Fiscal Balance estimates on a like-for-like basis.

- Regardless of Scotland's constitutional position, any future Scottish government will face continuing medium to long term financial constraints brought about by (i) rebalancing expenditure and revenues to keep debt interest costs low and affordable, and (ii) shifting demographics.

## REFERENCES


Centre for Public Policy for Regions, (March 2014), ‘Analysis of Scotland’s past and future fiscal position’

HM Treasury, (May 2014), ‘Scotland analysis: Fiscal policy and sustainability’

Office for Budget Responsibility, (March 2014), ‘Fiscal and Economic Outlook’

Office for Budget Responsibility, (July 2014), ‘Fiscal Sustainability Report’

Oil and Gas UK, 2014, (February 2014), ‘Economic Report’

Scottish Government, (March 2013), ‘Oil and Gas Analytical Bulletin’

Scottish Government, (November 2013), ‘Scotland’s Future: your guide to an independent Scotland’

Scottish Government, (March 2014), ‘Government Expenditure and Revenue Statement (GERS), 2014’

Scottish Government (April 2014) ‘State of the Economy’

Scottish Government, (May 2014), ‘Outlook for Scotland’s Public Finances and the Opportunities of Independence’

Scottish Government, (May 2014), ‘Oil and Gas Analytical Bulletin’

THIS PAGE IS INTENTIONALLY BLANK

Fiscal Affairs Scotland