

Some reflections on the Referendum campaigns and the post-Referendum economic agenda

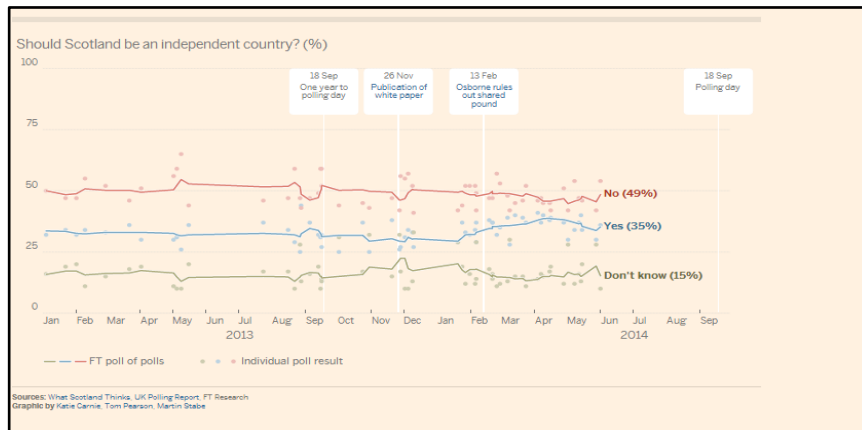
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Abstract

This third paper offers some summary thoughts on the manner in which the political context and the nature of the political interaction bear on the evolution of the economic perspective in the Referendum and thereby on the understanding and insights of public opinion at large. Specifically, it provides some reflections on how the political context imposes itself on the understanding of the critical economic challenges set out and discussed in the first and second papers. The paper then looks ahead to some of the crucial questions that may dominate the post-Referendum period and some of the key challenges that will be to the fore. It considers the importance of preparation for that phase of transformational change.

I. Some political reflections

There are several closely related observations that one might make on the approach to the Referendum of the competing campaigns to date. To the extent that these approaches bear on the understanding of the principal economic issues, they are immensely important and deeply relevant to the insights of the electorate in the run-up to the Referendum. Arguably, they go some way to explain the underlying evolution of public opinion over recent times, as illustrated in the Financial Times poll-of-polls².



Source: *Financial Times* (2014)

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² See for example, the *Financial Times* (2014) analysis: <http://www.ft.com/cms/s/0/2a5bdce0-c4a4-11e3-b2fb-00144feabdc0.html?siteedition=uk#axzz32R6IPRig>

The first observation focuses on the value that each campaign has placed upon political coherence. It has become something of received wisdom in recent years that strong, high quality leadership with a consistent, clear vision and well-directed messaging are a pre-requisite for successful political campaigns, especially when founded upon a unified and well-organised political grouping. Typically, what has deterred and confused electorates has been political disunity and in-fighting that overshadows and, indeed, proscribes the displaying of a coherent vision and ambition. In this latter context, electoral experience demonstrates the price that political parties have paid across the world when seeking to convince an electorate of their superior case.

In the present context, the key point is that – not least because many have *de facto* advanced their causes in the Referendum campaign as if this were an election – the pro-union alliance of several political parties has apparently not appreciated the value of behaving as if it were a single unified “party” and, on the contrary, has typically displayed many of the characteristics of the classic disunited party. Whether it is a reality or merely perception is not material, but the pro-union parties often appear to demonstrate the apparent belief that the Referendum will be won and thus they can afford the luxury of internal incoherence: that is, there would appear, collectively, to be a fundamental failure – at least in some quarters - to appreciate the importance of this Referendum and the uncertainty of its outcome.

In contrast, the pro-independence campaign – heavily dominated by a single party and led by a particularly dominant personality – has demonstrated absolute focus and discipline, projecting thereby a clear vision into an otherwise confused and divergent landscape. Most commentators see a pro-independence grouping that displays a sharp awareness of these issues and, in general, a more incisive insight into the sensitivities and concerns of the general public. Some may bemoan the perceived absence of evidence and rigorous analysis within the pro-independence campaign and dismiss the certainty with which the benefits of independence are asserted, but few would challenge the campaign’s political astuteness and single-mindedness.

The second observation relates to the striking difference that is apparent in pursuing a sharply defined and compelling new vision compared to an ill-focused campaign that poorly articulates the benefits of a prevailing political and economic system. In this regard, the pro-independence camp has sought to project a vision of ambition and aspiration compared to the present. The pro-union campaign is faced by an inherently more challenging task in that it needs to establish the perceived benefits of an existing union in which those benefits are familiar but poorly articulated. Many have observed that, despite the centrality of this issue, the pro-union campaign has, in fact, conveyed an unambitious and less than visionary perspective that many have found uninspiring.

Thus, the onus has been on the pro-union campaign to counter this through an emphasis on what could be achieved, even with existing powers and particularly highlighting the potential of new powers to transform the economy and society more generally. A campaign that argues merely for the preservation of existing systems and existing benefits – no matter how important those benefits are believed to be - will always struggle to compete with a campaign that has an exceptionally forward-looking and dynamic vision. In this regard, the independence campaign has been notably effective. The challenge for the latter cause is a different one altogether: it is whether the people trust that judgement and whether that vision is indeed achievable.

The third observation is that there has generally been a failure to establish the irreversibility of this event and the distinction between an election and a Referendum. It has often been difficult - if not impossible - to distinguish between a debate that would characterise a 4 or 5-yearly election from a once-in-a-lifetime constitutional Referendum. Hence, there has been the unfortunate paradox that the dominant issues have often – though, of course, not always by any means – been very short term in nature and very focussed on current challenges, with much less interest in the fundamental long term nature of the constitutional propositions. This is the central thesis underlying the *Six Tests* considered in the first and second papers of the Policy Section in this Commentary. Many of the policy issues advanced by both sides in the campaign, and the proffered policy solutions, have a distinctly ‘electoral’ feel to them, with the implication that, if they prove to be ill-conceived or misguided, the next election can reverse the decision.

Thus, while a Referendum ought not to be approached in the same light as an election, this distinction has not been successfully articulated by either the pro-independence or the pro-union groupings, often for their own deliberate strategic reasons. In consequence, it would appear that this critical point has failed to impress on the public mind.

Exploring new ideas, experimentation and risk-taking should arguably be analysed and understood from distinct perspectives according to the underlying capacity to correct or revise a choice, if such proves desirable. If this is indeed an appropriate approach to adopt, some would argue that this inherently injects a fundamental conservatism into the public mind in the context of a Referendum and promotes a greater degree of caution about more substantive transformation. More ambitious projects may tend to appear more risky merely because they are less familiar, in contrast to the continuance of more familiar projects for which the historical outcomes – while not necessarily unambiguously successful – are at least known. If this *is* so, the Referendum context of irreversibility places a heavier burden on the pro-independence camp to establish a picture of what the future will bring, and with what degree of certainty, than those favouring something much closer to the *status quo*.

II. The post-Referendum economic agenda in Scotland

Economic priorities. The post-Referendum period is arguably one of great importance to Scotland whatever the outcome of the vote. The fundamental economic and social questions that dominated our thinking prior to the financial crisis and global recession largely remain and, if anything, have become all the more challenging since the onset of the crisis in 2008. Adjustment and austerity have imposed huge strains on the economy and on society, while the continuing rise of the emerging economies has placed an ever-increasing demand on the Scottish economy to compete effectively.

Superficially, Scotland has emerged from the recession in relatively good shape, with an apparently strong labour market and growth that compares favourably with our primary trading partners in the developed world. However, this masks to some extent the significant continuing weaknesses in productivity and in the quality of employment, both of which are fundamental to the future competitiveness of the economy as a whole. There have been impressive gains in self-employment and in business creation, but it is critical to understand the quality of these trends and the extent to which they indeed represent a dynamic, creative economy or simply a pragmatic response to an otherwise weak economy. It is certainly not self-evident that the long-standing challenges have been mastered.

The familiar list of concerns does not immediately suggest that a major step change has been achieved and, even if it had over the past decade, the nature of global competition implies a continuing pressure to attain yet higher levels of achievement. The list would certainly include the questions that relate to the development of companies from small to medium size and from medium to large scale, global enterprises; the international penetration of Scottish companies; the creation of high-quality innovative micro enterprises; and the fundamental levels of innovation and commercialisation of both existing and new ideas, generated from the world class universities and research bodies in Scotland. Underlying these challenges remain key questions of policy design and policy effectiveness, as well as more deep-seated cultural concerns about the nature of entrepreneurialism in Scotland and the attitudes to risk-taking and ambition, all of which have been identified for many years as key priorities.

The key point here is that the definition of a new economic strategy will be necessary post-Referendum irrespective of the outcome. Its emphases will, of course, be very different depending on the constitutional state that emerges, whether an independent Scotland, a continuing Union with a greatly increased degree of devolved economic power or something little changed from the present. In each context, however, the same fundamental questions must be faced.

Continuance of the Union. As was observed in the second paper in the Policy Section of this Commentary, the advocates of enhanced powers within the Union have not, to date, articulated convincingly which specific new powers are required - and why - in order to deliver the economic objectives that they have identified. Proposals for new powers lack any detailed understanding of why these would be the optimal powers to assume and how they would be deployed. Through what specific mechanisms would these new powers impact on the economy and where is the evidence and reassurance that these channels would be effective?

While there will be strong pressure to formulate another package of powers to be transferred to Holyrood, it is important that it is underpinned by a clear understanding of what that package is designed to achieve for economic, social and environmental ends. Importantly – given the pro-union group's line of argument now – there will need to be a clear economic rationale for determining which areas of policy are most effectively managed at the UK level and which would bring greater benefit to Scotland from being devolved.

The current experience with the income tax powers that were transferred under the Scotland Act (2012) is not encouraging, with little debate at present about what those powers are designed to achieve and, most pressingly, how the powers might be deployed most effectively. Determining which powers should be transferred ought to be driven by an understanding of how the economic outcomes are best secured, and not solely by legitimate concerns of accountability.

Moreover, were the decision made to continue within the Union, there are many lessons from the Referendum campaign that could helpfully be absorbed. Two diverse examples make the point. Firstly, the campaign has clearly demonstrated the weakness in joint working between the UK Government and the Scottish Government on key issues of shared interest as, for example, with welfare policy. While welfare is reserved to the UK Government, it is clear that, such is its importance to both the economic and social policy of the Scottish Government and the local authorities, there is a great need for significantly enhanced understanding and coordination. Why is *all* welfare policy reserved; is there a

clear gain from devolving some elements? Why is the Scottish Government not far more active in influencing, and working with, the UK Government in the design of reserved UK policy, and why has the UK not been more open to this form of engagement? There is only a very weak history of interaction over arguably one of the key pieces of Government policy.

A second example, and one very different in nature, is the emergence of the Fiscal Commission³. It remains to be seen how widely accepted across the political spectrum the Commission will be, but, in principle, it represents an important step forward that is of potential value to any constitutional state. Some may question the scope of its proposed remit – which is indeed narrow and appears to exclude many critical elements of macroeconomic policy and, especially, detailed fiscal policy – but the idea of seeking independent input and oversight of Government thinking in this way is an important step forward.

Independence. Similarly, with a majority favouring independence, the reality of imminent independence will need to promote much hard thinking, shorn of the inevitable political rhetoric of a campaign and focussed tightly on the transitional period in which the establishment of the nation's credibility as an independent and sustainable entity will be paramount. The immediate post-Referendum period would rightly be dominated by the top priority challenges: many of which would need to be negotiated with urgency. The political climate post-Referendum would be expected to bear heavily on the nature of the negotiations: the degree of compromise and the bargaining power of the parties being closely related to the decisiveness – or otherwise – of the outcome.

The imminence of the UK elections imposes a further complication, with the UK parties certainly being concerned about the impact of the negotiations with Scotland on their electoral chances in 2015. One key question is whether the UK election would delay the negotiations and make the time horizon planned by the pro-independence camp unfeasible? Will the rest of the UK be preoccupied by the hugely significant UK elections? Two issues could easily absorb the UK Government's energies: firstly, the European Union dimension and the prospect of an EU Referendum under a new administration; and, secondly, the rise of UKIP in recent months and its electoral successes in the European and local elections, which have added another major threat to the historically dominant parties and their capacity to attain the majority government that they undoubtedly seek. In this context, how urgent will the resolution of the *Scotland issue* be?

Indeed, with whom would Scotland negotiate? It could face the prospect of starting negotiations with one UK administration, only to find, post-May 2015, it is faced by restarting them with a totally different administration and another group of UK political actors, with entirely different motivations and views on the specific issues to be resolved.

There are, therefore, a range of UK-specific challenges that make the post-Referendum period problematic in the event of a pro-independence vote, challenges that would necessarily need to be surmounted on an acceptable timescale.

As argued in the first paper in the Policy Section of this Commentary, the resolution of the currency question stands out as *the* key decision. It may not, however, be rapidly resolved. Even if the UK

³ See Scottish Government. *Scottish Fiscal Commission announced, May 2014*, <http://news.scotland.gov.uk/News/Scottish-Fiscal-Commission-announced-c43.aspx>

Government does agree to negotiate on a possible formal currency union, it is far from evident that the terms would prove acceptable to Scotland and reaching this conclusion could take a very protracted period. Were the negotiations to become entwined within the UK election campaign, the outcome would appear even less certain.

The technical and skill challenges would be significantly reduced were independence to be defined within a formal currency union: alternative currency options would be far more demanding in terms of the required institutional infrastructure and the required levels and types of technical expertise, such that the timescales for putting in place a new currency arrangement would inevitably be significantly longer. This, of course, does not suggest that it would be necessary to delay the day of political independence. It would, however, require an interim understanding with the UK about the continued short-term use of sterling while a new currency arrangement is developed.

Other questions would also take on a real urgency. Two examples suffice. Firstly, any period of transition is potentially of concern if the uncertainty that is inherent in any negotiations provokes behaviours that are detrimental to the new state, even if they are reversible in time. Limiting the time period is crucial, not least as it would be surprising if business investment, with the long term commitment that it implies, was not temporarily curtailed as companies wait to see precisely what form of independence would be designed⁴. Such a disruption is probably inevitable and difficult to counter but certainly its implications are minimised through rapidly defining the new economic system. Companies would be anticipated to adapt very rapidly to the political climate but would very likely hesitate in the face of economic uncertainty of this kind.

Secondly, even if the currency question remained unresolved for some time, formulating sustainable fiscal policy would be critical. At the moment of political independence, the new state would need to demonstrate fiscal stability: without this, the signalling effects to international markets would be immensely damaging, with implications for the cost of borrowing and, with some currency regimes, for the exchange rate. While the campaign has led to many claims that the present Scottish Government in this context would find great difficulty in reconciling its various policy proposals - as in the White Paper - within a tightly defined resource pot, the priority would not be the introduction of radical new policy on Day 1. While new policy directions would be an important step in meeting the political imperative to demonstrate the real value of independence and the difference it could indeed make, the immediate short term preoccupation would have to be with the continuity and stability of the system. Meeting expectations would be very demanding, but it is clear that there would be a huge pressure to finance existing programmes that were deemed essential, as, for example, with the payments through the welfare system and for other previously reserved areas of expenditure.

Misjudging the funding requirements in such a way as to endanger the continuity in the provision of a necessary public service would be seriously damaging for a new nation. Not introducing major new reform on Day 1 would be understood, albeit not acceptable to some groupings no doubt. Errors in revenue projection and expenditure flows – many of which would be very difficult to forecast with accuracy in a first year – can, to a degree, be accommodated through borrowing, of course, but the

⁴ *The recent comments by, for example, the CEO of B&Q illustrate the uncertainty that would concern business and, while this doesn't imply any long term withdrawal of business of course, any reductions or deferral of investment will be damaging in the short to medium term.*

dangers of disappointing the financial markets through what is perceived to be too great a reliance on new debt finance cannot be exaggerated.

The pro-independence camp has argued that the record of financial competence established since 2007 will carry significant weight with the international financial markets were independence to be adopted. This is an exaggeration, since Scottish Governments have in fact had only a very small capability to behave incompetently at an aggregate expenditure level, given the manner in which the Scottish budget is currently pre-determined and the very limited borrowing powers. Nonetheless, the public finances are recognised by most people to have been very well organised and effectively managed. Whether this impresses the markets is doubtful: the real test will be year 1.

Thus, while year 1 is undoubtedly the most difficult year with no historical experience to guide the forecasts in many areas of the budget, it is also the most important year in shaping all-important international perceptions. This suggests a degree of caution will need to be injected into the fiscal thinking and the overall fiscal stance, given the costs of over-optimism.

Overall, these reflections point to the importance of anticipating the post-Referendum period irrespective of the outcome of the vote itself. Whether with a continuance of the Union or with a decision to pursue one of the independence models, the dangers of a protracted period of indecision and uncertainty are significant. Independence would likely necessitate a protracted period of negotiation with both the UK and EU authorities to establish the precise form of independence that were to be adopted, while, with a *no* vote, a process of unknown duration to transfer greater powers to Holyrood would commence.

Recalling the ultimate objectives of constitutional transformation – as far as the economic aspirations are concerned, the reinvigoration of long term economic development in Scotland – would seem invaluable, not only to inject urgency into the re-establishment of a stable and sustainable economic context, and thereby provide the greater certainty that economic actors require, but also to more sharply focus the thinking and post-Referendum negotiations on the critical, desired outcomes that a settled constitutional form is designed to deliver.