ECONOMIC PERSPECTIVE

AN ANALYSIS OF THE SCOTTISH NATIONAL PARTY'S 1997 ELECTION BUDGET PROPOSALS

by Peter W. Wood, *Pieda* plc

Few, if any, economists would dispute that Scotland would be economically viable as an independent country. It is quite evident that Scotland's economy is larger, more prosperous and more soundly based than that of many existing independent states. However, there is much less agreement as to whether an independent Scotland would be more or less prosperous than a Scotland which remained within the UK. In the long term, the answer to this question would depend upon whether independence exerted a positive or negative impact on growth; much work remains to be done in this important area and it is difficult to reach any firm conclusions. In the **short** term, the ability of an independent Scottish government to maintain (or improve upon) the present balkanise of public spending and taxation would be critical to the living standards of Scots.

During the 1997 Election campaign the Scottish National Party produced a hypothetical budget which argued that an independent Scotland could increase public spending and tax breaks by £1,000 million in 1997-98 over and above the levels planned by the then government while raising taxes on incomes and tobacco by only £200 million. Further, over the period to 2001, the budget proposed increased public expenditure and tax breaks of almost £6,000 million (equivalent to a public spending increase of 20%) with the overall tax burden being increased by a mere £80 million. The SNP argued that these tax and spending plans could be implemented while **reducing** the national debt below Scotland's share of the UK debt. It was further argued that the extra public spending would result in a dramatic increase in the growth of the economy - for example, the budget document claimed that by the year 2000 the economy of an SNP led independent Scotland would be growing at a rate one third above the level which would apply if Scotland remained in the UK.

The key to the SNP's budgetary arithmetic is in the calculation of the budget deficit or surplus - the difference between Scottish public expenditure (consisting of spending by government departments in Scotland and Scotland's share of UK-wide items such as defence) and taxes raised in Scotland. The SNP claim that calculations of this deficit show that Scotland contributes more to the UK exchequer, when account is taken of North Sea Oil and Gas related revenues, than is spent in or on behalf of Scotland. An independent Scottish government would control the fiscal surplus which Scotland is said to be paying to the rest of the UK and could apply it to the programmes outlined in the SNP budget.

The calculation, indeed the existence, of this surplus relies heavily on the assertion that the Scottish budget deficit (excluding oil revenues) can be reliably estimated as being 17.9% of the corresponding UK budget deficit in every year. The SNP, therefore, calculate the Scottish "non-oil" deficit as 17.9% of the forecast UK deficits for the next few years. The SNP also assume that an independent Scotland would enjoy 90% of the revenues gained from various taxes on the production of North Sea Oil; not all commentators accept that Scotland could obtain this share of the revenues. The assumed revenues from North Sea Oil, along with an allowance for privatisation receipts, are subtracted from the budget deficit figure described above to produce the independent Scotland budget deficit. Figures based on the SNP procedures are shown in Table 1.

Data supplied to the SNP from HM Treasury in response to an SNP Parliamentary Question indicate that over the period 1979 -1995 the total of Scottish deficits was estimated to be 17.9% of UK deficits - though the proportion fluctuates from year to year. The same data also indicate that a Scottish government which secured 90% of North Sea revenues would have enjoyed substantial budget surpluses through most of the 1980s. This is the platform from which the SNP launch their projections of large budget surpluses for a Scottish exchequer in the late 1990s.

However the hypothetical budget surpluses which would have arisen in the 1980s are no guide to the position in the late 1990s. The first, and obvious, point is that North Sea revenues are now a fraction of the levels of the mid-1980s and will not be returning to those levels. The second point, which is of critical importance to the validity of the SNP argument, is that the assumption that the Scottish "non-oil" deficit/surplus will be a constant 17.9% of the UK level will not be valid in the conditions of the late 1990s.

Scotland's share of the UK deficit is obviously much more than Scotland's share of the UK economy or population (8.8%). The reason for this is that Scotland's share of public spending (10.2%) is greater than its share of tax revenues (8.9% - excluding, for the moment, North Sea revenues). As a result of this, Scotland has a structural deficit in its public finances such that if the UK as a whole had a **zero** deficit Scotland would still have an excess of spending over revenue. It also follows from this that the smaller is the UK deficit the **greater** the share accounted for by the Scottish element. This point is clearly borne out by the figures obtained by the SNP.

In providing information in response to the SNP question, the Treasury placed a large "Health Warning" on the data for the period before 1990. Table 2 reproduces the data for the period since 1990. In that table the Scottish share of the UK deficit is clearly seen to be higher when the UK deficit is relatively low. In calculating its future Scottish budget deficits, the SNP has used a figure for the Scottish share which is **too low.** The UK budget deficit is projected to fall steeply over the next few years and to become a surplus in the year 2000. Logic and the evidence of the past both indicate that under these conditions the Scottish share of the UK deficit will rise sharply.

By applying the figure of 17.9% to projected "non - oil" UK budget deficits in the range £7,000 to £24,000 million the SNP has underestimated the Scottish deficits for the years concerned. For example, the UK non oil budget deficit for 1999/00 is projected to be £6,700 million: when the UK deficit was last near that level, in 1990/91, the Scottish deficit accounted for 57% of the UK total.

The procedure adopted by the SNP in calculating the budget deficit tends to conceal more than it reveals about the generation of the budget deficit or surplus. The budget deficit or surplus is determined by the balance between revenue and spending and an analysis which focuses on the nature and level of public spending, taxation and other revenue gathering will be clearer and more comprehensive than the process of projecting deficits. Studies of Government Expenditure and Revenue in Scotland, particularly those prepared by the civil servants in the Scottish Office, have provided a growing volume of detailed evidence on which to build an assessment of the likely budgetary position of an independent Scotland.

The Scottish Office publication **Government Expenditure and Revenue in Scotland 1994-95** contains detailed figures for spending by the Scottish Office and various calculations of Scotland's share of UK wide spending and of government revenues. Taking the figures from that report and uprating them in line with the expenditure and revenue information contained in the **Financial Statement and Budget Report 1997-98** (the Red Book) and taking on board the SNP's figure for Scotland's share of North Sea revenues, we obtain the Scottish Budget deficit figures shown in Table 3.

The SNP **has** produced estimates of income and expenditure for 1996-97 which show higher receipts and lower spending than implied by the figures above. In particular, the SNP have argued that the government's figures underestimate Scottish Income Tax payments. However, the SNP's criticisms of the extensive analysis by the Inland Revenue used to produce the estimates are not well founded. Moreover, the SNP's proposed alternative to the Inland Revenue procedures, i.e. that income tax revenues should be calculated pro-rata with population, is flawed in that it fails to allow for the fact that Scotland has proportionately more low earners and fewer high earners than has the rest of the UK. The Inland Revenue survey data represents the best available basis for calculating income tax revenue. The SNP's rejection of Inland Revenue calculations leads, for example, to an overestimate of Income Tax revenues amounting to £600 million.

The SNP income and expenditure calculations generally understate the costs which would be involved in running an independent government. These costs, which were listed in the Scottish Office calculations as the "Other Unidentified Expenditure" element, amount to over £1,000 million.

The figures set out in Table 3 imply that in 1997-98 an independent Scotland would have a budget deficit of 3.7% of GDP. Scotland would be even less well placed than Germany to meet the Maastricht Treaty criterion for Debt/GDP - though it remains to be seen whether this will be "fudged"! Perhaps more importantly, such deficits would certainly produce an unfavourable reaction in the capital markets. Implementation of the proposed SNP budget would make the situation untenable by any standards since the deficit would be raised to 5% of GDP.

The SNP Budget document went on to propose further spending increases so that by 2001 the budget deficit would have risen to almost £7,000 million: this would be nearly 10% of GDP even allowing for steady GDP growth and would plainly be far beyond the realms of the financially sustainable.

While the SNP argues that most of its spending increases would be financed out of a large (non-existent) relative financial surplus, it also argues that its expenditure programme would produce rapidly increased economic growth, rising government revenues and falling welfare spending. This claim is based on modelling by Mackay Consultants. The structural equations underlying this model are not shown by the SNP but it would be useful to be able to inspect them. The results generated by this model imply that the economy has distinctive characteristics since a very large boost to demand is shown to produce rapid output growth without adverse impacts on inflation or, apparently, the Balance of Payments.

Quite aside from the issue of the underlying economic model, it is a feature of the SNP budget that it involves a large injection of demand to the economy while not involving measures which could be expected to impact on the supply side of the economy in the same time period if at all.

As stated at the beginning of this paper, Scotland could function perfectly well as an independent country and with some determined belt tightening in terms of reduced public spending and/or tax increases the country could reach the Maastricht Debt criterion for EMU. Whether the Scottish economy would become a "Celtic Tiger" in the long term is far less certain but the idea that independence would deliver an instant public spending "bonus" is untenable.

Table 1				
	UK Budget Deficit/Surplus (ex Oil Revenues)	**Scottish Deficit (ex Oil Revenues)**	**Scottish Oil Revenues**	**Overall Scottish Deficit/Surplus**
97/98	-£23,700 million	-£4,000 million	£3,600 million	-£400 million
98/99	-£15,900 million	-£2,700 million	£3,500 million	+£800 million
99/00	-£6,700 million	-£1,139 million	£3,300 million	+£2,161 million
00/01	+£3,500 million	+£595 million	£3,200 million	+£3,795 million

Table 2		
Year	**UK Non-Oil Deficit**	**Scottish Share**
1990/91	£8,700 million	57%
1991/92	£26,100 million	22%
1992/93	£52,100 million	17%
1993/94	£57,200 million	17%
1994/95	£48,100 million	17%

Table 3				
Year	**Scottish Expenditure**	**Scottish Non-Oil Revenue**	**North Sea Oil Revenue and Privatisation**	**Budget Deficit**
1997-98	£32,500m	£26,300m	£3,800m	£2,400m
1998-99	£33,600m	£27,800m	£3,600m	£2,200m
1999-00	£34,500m	£29,500m	£3,400m	£1,600m
2000-01	£35,400m	£31,000m	£3,200m	£1,200m