The White Paper Project

Beyond GERS – Scotland's fiscal position post-independence –

Craig Dalzell

COMMON WEAL POLICY

The case for Scottish independence was never and cannot ever be a tablet of stone – it must be made and re-made constantly as circumstances change.

It seems that, after Brexit, everyone is very conscious of the fact that the case for an independent Scotland is in urgent need of renewal. From Alex Salmond to Joseph Stiglitz, big players in the 2014 referendum accept that there's aspects of the argument that need updated in

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These are some of the big structural questions that Common Weal is working on answers to in what we're calling our White Paper Project.

Our White Paper is not going to be like the Scottish Government's in 2014, which attempted to amalgamate structural issues with specific policy offers. We won't be looking at, for example, whether an independent Scotland would raise or lower taxes. As far as feasibly possible, we're going to try to focus only on the systems and structures in establishing an independent Scotland, not our own policy ideas.

It will be for a future election in an independent Scotland to decide on the specific policies to be pursued. What we want to prove wit
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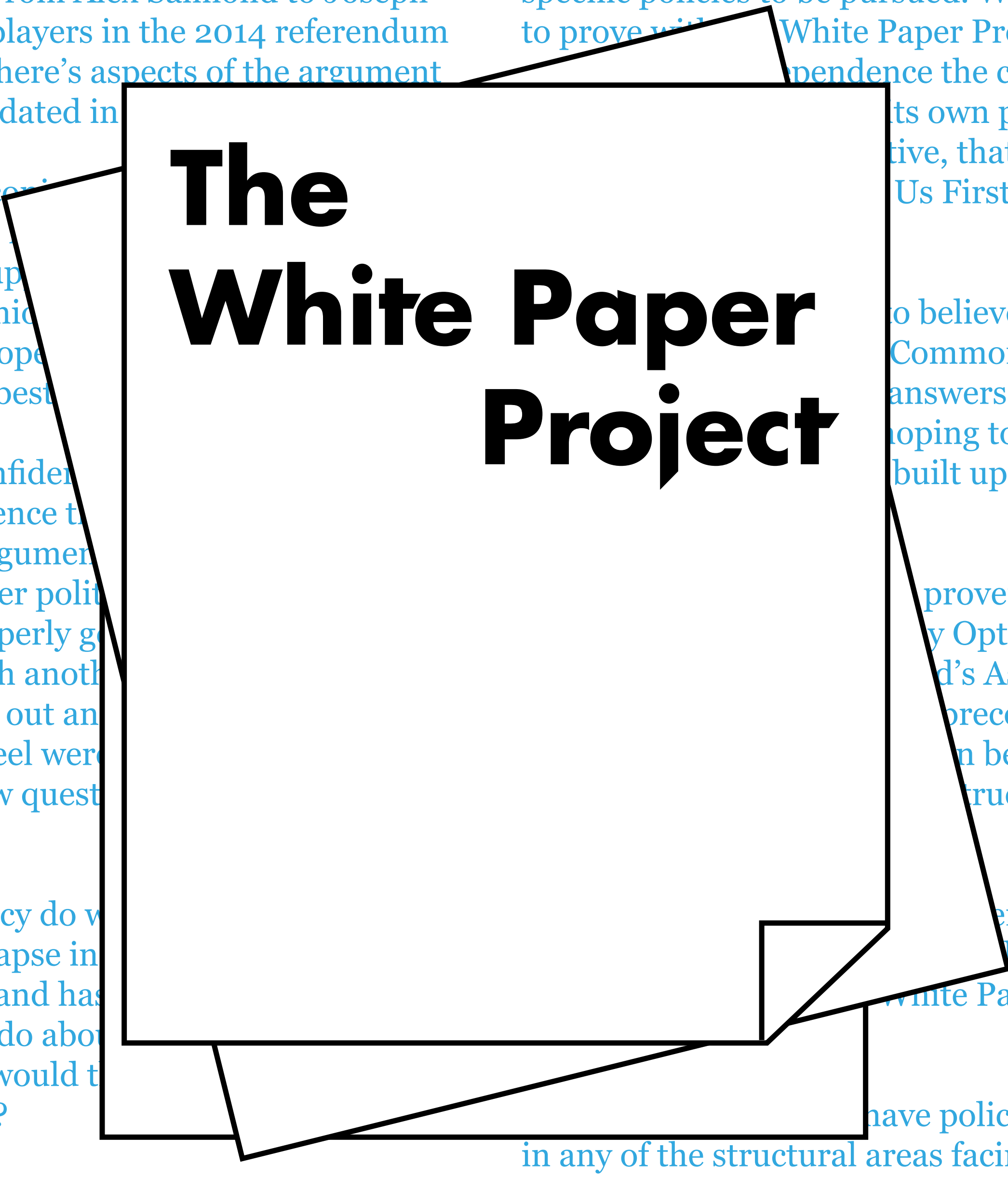

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have policy expertise in any of the structural areas facing an independent Scotland and would like to volunteer your thoughts or time, get in touch. If you are just very keen to see the White Paper Project be the best it can be then help us improve our limited research capacity by becoming a regular donor to Common Weal. We can't wait on high for the case for Scottish independence to be renewed – let's get on with it ourselves.

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Preface

GERS (Government Expenditure and Revenue Scotland) 2015/16 reported Scotland's fiscal deficit to be in the region of £14 billion per year, portraying Scotland as the country experiencing some of the most challenging financial circumstances in Europe.

However, this study must be viewed firmly in the light of Scotland being a member nation of the United Kingdom and, as such, any attempt to use them to project the finances of an independent Scotland must be treated with caution and qualification.

The very act of independence will result in significant redistributions and reallocations of government resources which will likely result in economic benefits accruing to Scotland. Additionally, decisions on how to establish and govern new Scottish state institutions will also improve Scotland's budget at the point of set-up, further strengthening the fiscal position vis-à-vis that presented in GERS and that of the rest of the United Kingdom.

Key Points:

• The act of independence brings with it many structural changes which will significantly benefit Scotland's fiscal position to the effect of several billion pounds equivalent per year.

• By shifting the focus of defence from one of outward projection and nuclear deterrent to one more in line with modern European nations, savings of approximately £1.1 billion per year can be realised. Even in the event of Scotland committing to NATO member defence spending targets of 2% of GDP, the increased spending within Scotland can be expected to have additional economic benefits resulting in tax revenue increases of around £300 million per year compared to the status quo.

• A reasonable case for the debt and asset negotiations due to independence will result in Scotland saving up to £1.7 billion per year in debt interest repayments.

• The legal requirement of the UK Government to provide the UK State Pension for all those who have met the criteria would likely have to be the subject of negotiation post-independence, but the expectation would be that this would lead to billion-pound savings for the Scottish Government in at least the first year.

• A substantial fraction of unidentifiable spending accounted to Scotland is, in all likelihood, spending to cover UK wide government functions which Scotland may or may not choose to replicate or reproduce in some form post independence. Whilst savings will be made by reason of lower running costs and wages in Scotland compared to London, the additional economic benefits of spending in Scotland instead of elsewhere in the UK could result in additional tax revenues of approximately £719 million per year.

• The opportunity for an independent Scotland to redesign the tax code from the ground up, eliminating built in inefficiencies, loopholes and exceptions will help reduce the "tax gap" by approximately one-third, increasing revenue by about £3.5 billion per year.

• Whilst the UK's tax revenue as a percentage of GDP is around the OECD average, many countries neighbouring it successfully maintain higher rates of tax revenues which, if replicated in Scotland, could further improve the financial situation by several billions per year.

• Even without increasing tax revenue as a percentage of GDP, an independent Scotland could be placed in a position of relative "deficit parity" with the current UK budget.

Introduction—The Limitations of GERS

A crucial and fundamental question throughout the Scottish independence debate has been "Would Scotland be richer or poorer as an independent country?".

Delivering an answer to this question is no straight forward task due to the nature of the calculation and the presentation of Scotland's fiscal situation in publicly available government data. Documents such as the UK Government's Public Spending Statistics (PSS) and Public Expenditure Statistical Analyses (PESA) or the Scottish Government's Government Expenditure and Revenue Scotland (GERS) have presented present income and expenditure in a manner which not only masks an independent Scotland's fiscal position at the onset of independence but does not accurately reflect the potential or limits of the Scottish fiscal position.

The argument against Scotland's fiscal sustainability is that the deficit – as highlighted by GERS in recent years – is one of the largest in Europe and therefore, without the "broad shoulders" of the UK providing subsidy for Scottish public spending, austerity would be necessary in the event of a Yes vote in a future referendum.[*1]

The challenges to Scotland's finances should not be understated, but this view says far more about the nature of devolution in the UK and Scotland's place within that Union than it does about Scotland's prospects as an independent nation. In particular, public spending in Scotland can be allocated into one of three categories. That which is spent in Scotland by the Scottish Government, that which is spent in Scotland by the UK Government and that which is spent outside Scotland by the UK Government but which is deemed to be either "on behalf of" Scotland or in the shared interest of all nations and regions of the UK.

This report is focusing on an independent Scotland's fiscal position at the point of set-up, prior to subsequent elections and manifesto commitments, which would contain within it the possibility of a whole other set of possible changes that could further enhance Scotland's fiscal position, if the Scottish people chose to vote for such measures.

Whilst the first two categories would be largely an accurate representation of public spending in Scotland at the onset of independence (after which it would be subject to changing policy decisions), the last category is of particular interest as it may include spending on projects which do not, in fact, incur any benefit to Scotland, or may incur an indirect benefit but would do so regardless of whether Scotland contributed to it financially or not.

This report shall seek to highlight some of these areas on which an independent Scotland could expect to see significant savings by dint of its withdrawal from the United Kingdom and the establishment of new Scottish state institutions. In doing so, we emphasise that this report is focusing on an independent Scotland's fiscal position at the point of set-up, prior to subsequent elections and manifesto commitments, which would contain within it the possibility of a whole other set of possible changes that could further enhance Scotland's fiscal position, if the Scottish people chose to vote for such measures.

Spending on Behalf of Scotland

Defence

The question of defence is possibly the subject which will lead to the largest immediate distinction in policy between Scotland within the UK and an independent Scotland. The priorities of the UK, which involve an active nuclear deterrent, a blue water navy and the ability to – at least in theory – project unilateral force are likely to differ greatly from a Scotland seeking to prioritise defending its own sovereignty as a nuclear free country. Even within this scope, the very definition of defence can differ greatly depending on how one defines the threats from which Scotland should be defended. The Reid Foundation's 2012 paper "No Need to Be Afraid"[1] examined the possible threats to Scotland's security and found that the probability of territorial threats such as invasion by a foreign power were likely to be substantially lower than threats to security from environmental disruption or cyber attacks. A defence policy seeking purely to maximise security may look entirely different from one seeking also to enhance or retain political posture.

With respect to Scotland's budget, GERS assigned £3.0 billion to defence expenditure in 2015-16, all of it marked as UK Government spending. Whilst the UK Government does not routinely publish identifiable defence spending for Scotland a series of direct Parliamentary questions[2] indicated that the 2007-08 spending within Scotland was £1.7 billion at a time when GERS assigned £2.8 billion to Scotland in expenditure. Equivalent figures for 2015-16 would be around £1.8 billion out of £3.0 billion. This disparity can be assumed to cover the amount spent "for or on behalf of Scotland" either across facilities and operations elsewhere in the UK or across the world.

The projections for an independent Scotland's defence spending will greatly depend on the defence stance taken by Scotland and is thus subject to precise policy decisions. Whilst specific recommendations regarding the composition of this defence structure have been published elsewhere[3, 4, 5], some indication of the prospective costs of defending Scotland can also be found by

* We do not accept the fundamental premise of this argument that austerity necessarily reduces a public-sector deficit, is the only possible remedy to the deficit or even that the deficit is the most important indicator of economic security. These points have now been made by, among others, the IMF and OECD. However, for the purposes of this report, we are willing to take this argument on at face value.

comparing Scottish defence spending to that of other comparable countries.

At the time of writing only 5 of the 28 NATO members – the USA, the UK, Greece, Poland and Estonia – actually meet or are close to meeting NATO's 2% target and fully a third of members are actively decreasing military spending with respect to GDP.

The £3.0 billion cost assigned in GERS represents roughly 1.94% of Scotland's GDP which is close to the desired 2% of GDP spend that NATO has lobbied members to try to meet in coming years. Clearly, if an independent Scotland wished to remain part of NATO and if it reaffirmed the UK's commitment to meeting that 2% target then defence spending would remain largely as it currently is.

However, at the time of writing only 5 of the 28 NATO members – the USA, the UK, Greece, Poland and Estonia – actually meet or are close to meeting NATO's 2% target and fully a third of members are actively decreasing military spending with respect to GDP[6]. The sustainability of this target therefore remains to be seen.

Further, whilst it is still currently the Scottish Government's policy to seek NATO membership post-independence this is a hotly contested area of debate even within the Scottish National Party. It may be that they or others determine that membership of alternative military and defence alliances and partnerships – such as the EU's SAFE program and/or UN Peacekeeping initiatives – better match Scotland's defence and military requirements. Across the EU, the average level of military spending is approximately 1.24% of GDP[7] and notably Ireland, with its policy of military neutrality, spends just 0.45% of GDP on defence[8]. If Scotland were to match either of these figures it would represent savings on the Scottish balance sheet of £1.1 billion or £2.3 billion per year respectively.

Defence spending model	Defence Spending in Scotland (£mn)	Increase in Spend within Scotland (£mn)	Fiscal multiplier Effect on Revenue (£mn)	Total Savings Compared to Status Quo
Ireland (0.45% GDP)	£700	-£1,000	-£200	£2,130
EU Average (1.24% GDP)	£1,950	£250	£50	£1,130
NATO Target (2.0% GDP)	£3,100	£1,400	£300	£230

It should be noted, however, that any figure spent in Scotland above that which is currently actually spent within Scotland may be regarded as creating additional economic and fiscal benefits. Applying a standard IMF defence spending fiscal multiplier of 0.6[9, 10] shows that the additional £1.4 billion of defence spending required for Scotland to meet NATO's 2% target would result in a boost to Scotland's GDP of £840 million per year. Given that Scotland's average tax revenue across all sectors is 34% of GDP, this implies a boost to Scottish tax revenue of just under £300 million per year. Thus, even in the case of Scotland meeting the NATO target, Scotland's financial situation could be expected to see some improvement over the current situation. Conversely, if Scotland were to cut military spending to levels comparable to Ireland, the fiscal multiplier could be expected to operate in an inverse manner such that roughly £200 million per year would be lost from subsequent income. Each of the three cases outlined above are summarised below showing the prospective savings to the Scottish budget gained through each of them.

Debt Interest

At £2.8 billion in 2015-16 and representing 4% of the total assigned expenditure budget of Scotland, the interest paid on Scotland's "share" of UK public debt represents a significant amount of entirely reserved spending. This figure will almost certainly be reduced upon independence due to the nature of the division of assets and debts between separating states. The precise details of various separation scenarios have been laid out in Common Weal's research paper "Claiming Scotland's Assets"[11] which places a reasonable range of savings at somewhere between £800 million and £2 billion per year depending on the negotiating strategy adopted by Scotland upon independence. The upper value of this range represents a "zero-option" model of asset separation which would allow an independent Scotland the maximum flexibility to purchase what is required to run itself as well as to leverage the comparative advantages to denominating any incurred debt in its own sovereign currency[12].

Pension Liabilities

The current legal position of the UK government regarding pensions is that all current UK citizens who have fulfilled the requirements including the paying of national insurance are entitled to a UK state pension regardless of whether or not they choose to retire within the UK[13]. Whilst this position is entirely negotiable between the Scottish and rUK Governments, if it were to be adopted in full – which would be in line with the UK claiming possession of all UK assets and liabilities – then this would be expected to reduce the Scottish deficit by up to £8.5 billion[14] in the first year of independence. Of course, this sum would gradually re-accumulate onto the Scottish budget as UK pensions cease paying out over time, at a rate of approximately 5% per year as per UK national life expectancy statistics[15], and as new Scottish pensioners start claiming. This re-accumulation may also be affected by any decision by the UK government to not peg such pension payments to inflation – as is the case for many UK emigrants who claim UK pensions – which may induce the Scottish Government to issue some form of "top-up". A similar issue may also arise in the case that the UK pensions are paid or linked to a GBP amount which significantly depreciates relative to a prospective independent Scottish currency.

The current legal position of the UK government regarding pensions is that all current UK citizens who have fulfilled the requirements including the paying of national insurance are entitled to a UK state pension regardless of whether or not they choose to retire within the UK.

For the purposes of this paper, three scenarios will be proposed. A 'low' estimate in which the UK will continue paying public sector pensions only, which amounts to around £1 billion of expenditure. A 'high' estimate involving the entire pension liability minus those pensions which begin from the date of independence and any further top-ups, saving approximately £8 billion in the first year. The third 'middle' scenario involves a negotiated settlement whereby the UK pays half of the Scottish pension liabilities creating a saving of £3.5 billion in the first year.

Overseas Spending

The UK's Public Expenditure Statistical Analysis records indicate a sum of UK spending outside the UK of approximately £26.5 billion in 2014-15 but[16] does not give a readily clear breakdown of the spending contained within this. If an expenditure share is applied to Scotland then this would assume around £2.4 billion which would need to be accounted for.

The largest single fraction of this sum is likely to consist of the UK's foreign aid budget (approximately £8.5 billion in 2015-16 split between £8.2 billion in economic aid and £0.3 billion in foreign military aid[17]). The precise manner in which an independent Scotland would target and deliver foreign aid would be a matter entirely for policy makers to debate and decide – especially with regard to the proportion of military aid – but for the purposes of this paper the assumption will be made that Scotland will spend on foreign aid roughly in line with its current attributed spending as a percentage of GDP, around £1 billion per year, as was laid out in the 2013 Scotland's Future White Paper[18].

The next largest single item within this category is the running of the Foreign and Commonwealth Office. It is the mark of an independent country that it is able to establish embassies in countries with which it wishes to have official diplomatic relations as well as to render assistance to citizens who may require it while visiting those countries. Once again, the precise foreign policy to be followed by an independent Scotland will be one for the government of the day and how it wishes to present itself to the world.

The total running costs within PESA indicate that the rough running costs of the UK FCO network is around £7.5 million per diplomatic post per year. In contrast, the Government of Ireland spent around €76 million across its 69 diplomatic posts - €1.1 million per post. Its most expensive embassy, in London, was recently valued at €5.2 million.

It is worth considering that while the UK has one of the most extensive diplomatic networks of any country in the world – a relic of the state's former status as a globe spanning Empire – the total budget for the FCO is comparatively modest on the scales of national expenditure at a little under £2 billion per year. In extremis, if Scotland wished to replicate the full extent of the UK FCO, it is not beyond the realms of possibility for it to do so. However, this figure belies the comparative expense of running a UK embassy compared with other nations. A 2010 valuation found the capital costs of all of the UK's 268 diplomatic posts came to a sum of £1.87 billion[19] – A little under £7 million per diplomatic post with the three offices within the UK totalling £237 million between them.

The total running costs within PESA indicate that the rough running costs of the UK FCO network is around £7.5 million per diplomatic post per year. In contrast, the Government of Ireland spent around €76 million across its 69 diplomatic posts - €1.1 million per post. Its most expensive embassy, in London, was recently valued at €5.2 million[20]. Clearly, a Scottish foreign office which based its operations on utility and price efficiency rather than, perhaps, prestige would be able to find significant savings in its budget. This could be further compounded by strategic embassy sharing agreements modelled on deals like the UK-Ireland and UK-Canada embassy sharing arrangements as well as by leveraging the right of all EU citizens to expect diplomatic assistance from the embassy of any EU member state if they are in a country in which their country of origin is not diplomatically represented (although there will, of course, be limits to the extent to such sharing agreements as it will be nearly inevitable that many countries will wish their own independent embassy within some higher profile nations like the USA, Japan or the UK).

One final consideration within the topic of foreign diplomatic spending is the realisation that an independent Scotland will itself attract embassies from other nations who wish to be represented here. The running of these diplomatic posts may themselves have a modest but noticeable economic impact on the areas in which they are located (likely, although not inevitably, to be Edinburgh) in a similar manner to that caused by the repatriation of our domestic civil service. The magnitude of this impact is understandably difficult to estimate however as it is entirely dependent on the policy decisions of those countries who may or may not wish to set up an embassy in Scotland.

It is generally unclear what the rest of the UK's overseas budget consists of but it can be reasonably assumed that it contains 'membership fees' for international organisations such as the UN, IMF, World Bank, Council of Europe and other such bodies (which Scotland may be expected to continue funding as per our current proportional share) as perhaps as well as overseas military expenditure not previously covered within the defence budget. Given the uncertainty around these figures and the others discussed in this section, this paper shall assume that the entire £2.4 billion expenditure share of the UK's overseas budget shall be continued by an independent Scotland in the first instance with a discussion on spending levels and targeted priorities to come in subsequent budgets.

Other Expenditure Outwith Scotland

Whilst GERS records expenditure for or on behalf of Scotland in 2014-15 as £67.879 billion[21], the UK wide Public Expenditure Statistical Analysis records a total identifiable expenditure in Scotland for the same period as £55.475 billion[22] – of which two of the largest spending categories are the largely reserved social protections and pensions (£23.591 billion) and the largely devolved healthcare provisions (£12.176 billion). After accounting for defence, public debt and overseas spending outlined above as well as accounting adjustments which are recorded in GERS, there remains £2.35 billion per year of non-identifiable spending on Scotland's accounts which cover areas of UK wide governance such as managing reserved taxation and policy, revenue and customs, research and development and others.

As well as current expenditure, there exists items of UK capital expenditure which are regarded as being of "national importance" which are added to Scotland's total non-identifiable expenditure budget regardless of whether or not they are physically located in Scotland. High profile recent examples of such projects include Trident replacement[23], HS2[24], London Crossrail[25] and the upcoming planned renovation of the UK Houses of Parliament[26]. It can be estimated from publicly available estimates that the Scottish share of these and other national capital projects could come to around £30 billion. However, it should be carefully noted that many of these projects are based on timetables stretching out over several years and, in some cases, decades therefore if a Scottish contribution to them were to be ceased upon independence then the actual impact on the year-to-year deficit would be considerably smaller. Estimates for the total costs to Scotland for these projects in the coming years can be difficult to identify. However, we do know estimates for specific projects, including Trident running at £200-£400 million per year for up to 40 years, and the Palace of Westminster replacement costs at £100 million per year for 30 years or up to £500 million per year for 6 years depending on the renovation schedule[27].

Whilst it is well beyond the scope of this paper to itemise every source of expenditure within the sum of non-identifiable spending, it must be remembered that it does not entirely represent a figure to be saved in the event of independence as it includes areas covering spending on government services which would necessarily be replicated in Scotland. An important example of this is the management of currently reserved government functions and a greatly expanded civil service. Direct savings may be realised in the form of lower running costs due to relocating many of these functions to Scotland from London.

As in the case of defence spending outlined above, the additional fiscal multiplier benefits of relocating such activities to Scotland cannot be understated. In 2010 the UK Office of Budget Responsibility estimated[28] that the fiscal multiplier for additional capital department spending and for additional resource department spending is 0.6 and 1.0 respectively. However, it should be very carefully noted that the IMF, on whose data the OBR had based those figures, have since[29] revised their estimates for the calculation of such fiscal multipliers upwards into the range of between 0.9 and 1.7 at a minimum and leave open the possibility of higher multipliers depending on economic conditions. This means a potential boost to Scottish GDP, economic activity and thus tax revenue of several billion pounds per year, further closing the deficit gap. If conservative fiscal multiplier estimates are assumed then the effect on Scottish GDP from relocating £2.35 billion worth of government spending to Scotland could be around £1.4 billion which could imply an increase in Scottish revenue of upwards of £480 million whereas the multiplier ranges now used by the IMF would imply increases in revenue of between £0.72 billion and £1.36 billion per year.

Raising Revenue

The Tax Gap

No complex system can exist which does not have weaknesses, loopholes or failings. This basic tenant of systems analysis is no more true than within a state's tax code. There will always be some form of shortfall between what should be collected according to the letter of the tax law versus what is actually collected in any given year. From errors and failure to correctly filling in paperwork, through deliberate non-payment, avoidance and evasion up to outright criminal attacks and exploitation of the system there will always be ways that tax revenue can be lost. This is to say nothing of loopholes and tax "bungs" deliberately written into the system by policy makers which, as they are "legal", often go uncounted as part of the gap.

HMRC estimates that the UK's tax gap in 2013-14 was around 6.4% of revenue or about £34 billion[30] whereas a study by tax expert Richard Murphy for PCS estimated that the figure was far higher at £119.4 billion[31] which is accounted for by placing more weight on offshore tax abuse, capital gains tax and losses of inheritance tax than is done by HMRC.

Independence would give Scotland the opportunity to dispense with the UK's notoriously Byzantine tax code and create one better suited for our nation and without the legacy of loopholes, dodges and pandering to business which has plagued the UK system and penalised everyone who relies on public services.

Reflecting HMRC's figures – which have been criticised by several sources as being far too conservative[32] – onto Scotland's budget implies a loss to revenue of around £3.4 billion per year, whereas the PCS estimates would be closer to £12 billion per year. Independence would give Scotland the opportunity to dispense with the UK's notoriously Byzantine tax code and create one better suited for our nation and without the legacy of loopholes, dodges and pandering to business which has plagued the UK system and penalised everyone who relies on public services. Even relatively modest corrections (recovering, say, a third of HMRC's tax gap estimate) would have a significant impact on Scotland's deficit, equalling around £1.12 billion. A more ambitious program of closing up to half of the tax gap as measured by PCS would be worth up to £6 billion per year. Between these two measures, a middle estimate of £3.5 billion (representing a little under a third of the PCS tax gap estimate) could be achievable. This exercise highlights the opportunity that independence will bring to Scotland. It need not and absolutely should not be the case that Scotland begins life with a tax structure which simply looks like a modified version of the UK's own. Instead some serious thought should be invested now, well before the date of independence, to devise and design a tax system which both better suits the economic needs of Scotland and which reduces the ability for those with the means and the desire to avoid or evade their tax responsibilities to do so.

New Fiscal Foundations

It has been remarked that Scotland could not afford "a Nordic style welfare state on an American style tax system" so while looking at the tax gap it is worth reconsidering Scotland and the UK's tax system with respect to some other neighbouring countries.

Figures from the OECD show[33] that the average tax revenue collected by their member states is around 34% of GDP. In this respect, the UK appears roughly in line with this average at 36% of GDP but this average conceals a broad spread even among European countries ranging from 26% of GDP (Switzerland) to 50.9% (Denmark). Further, analysis of GERS shows that Scotland's tax revenue as a percentage of GDP lags slightly behind the UK's at 34% and that the largest cause of this is a comparative shortfall in income tax (£1.7 billion less than our population "share" of the UK's total income tax take).

It is not, at this time, clear how this shortfall has come about with one possible suggestion including accounting adjustments due to Scottish employees belonging to larger UK companies being recorded in HR departments in England. It should be noted, however, that now that income tax is partially devolved to Scotland, Scottish domiciled employees now have a distinct tax code which would eliminate this effect, if it is real, as a source of the discrepancy.

The effect of raising total tax revenue to the same percentage of GDP as the UK would represent an increase in revenue of £2.7 billion.

A more likely reason is that lower pay and differences in income distribution in Scotland has the effect of reducing tax receipts but this has proven difficult to verify due to a paucity of data on income distribution in the UK. Even where percentile resolution income data is available[34], Scottish sub-samples are small enough that either disclosure protection rules preclude their release or the data has to be modelled to the point that discussion of those percentiles is impaired. That said, whilst the Scottish Government has claimed that median income in Scotland is higher and income inequality is lower than the rest of the UK[35] the lower number of higher and additional rate earners in Scotland compared to the rest of the UK coupled with the fact that the tax bands are optimised for the UK as a whole[36] has the effect of reducing Scotland's overall income tax revenue per capita compared to the UK.

If this kind of analysis is applied across all taxes in Scotland the effect of raising total tax revenue to the same percentage of GDP as the UK would represent an increase in revenue of £2.7 billion. This could be regarded as the most modest correction to which an independent Scotland could aspire. If the nation did indeed wish to create a more Nordic model of society then building towards more Nordic levels of taxation may be considered. According to the OECD figures quoted above, the GDP weighted average tax revenue across the Nordic countries (Denmark, Finland, Iceland, Norway and Sweden) is 43% of GDP. Increasing Scotland's tax revenue to this level would represent an additional £13.7 billion worth of revenue whereas increasing to the Danish level of taxation (50.9% of GDP) would represent an increase in revenue of £26 billion per year.

It should be noted that it needn't follow that increases in tax revenue would necessarily be due to increases in tax rates (especially increases in direct income tax rates) as increases in wage levels, reductions in wage inequality and other impacts of a Scottish tax and expenditure system designed for and by Scotland may take the fiscal balance at least part of the way to the levels identified here. While this would not affect Scotland's fiscal position at the point of set-up, it provides clear evidence of how tackling inequality and raising wages can boost an independent Scotland's budget substantially.

Country	Tax Revenue as % of GDP	Scottish Equivalent Tax Revenue (£mn)	Change in Revenue Compared to Status Quo
Scotland (Status Quo)	34%	£53,748	£0
UK Average	36%	£56,528	£2,780
Nordic Average	43%	£67,417	£13,669
Denmark	50.9%	£79,772	£26,024

Beyond GERS—Building Scotland's Budget

Much of the argument surrounding an independent Scotland's budget is complicated by the ad hoc nature of Scotland's current and developing devolution situation. In particular, many of the discussions about spending, especially spending outside Scotland, is complicated by discussions of the implications to the Barnett Formula[37] which indicates that much of the reserved spending in England accrues increases to the Scottish Government's block grant, the so-called "Barnett Consequentials" and thus at least partially compensates Scotland for that spending. In practice, it is not always possible to identify exactly how much of these consequentials will accrue ahead of time and the debate over Scotland's fiscal position is made significantly more complicated by that factor. In any case, they would cease to be relevant upon independence. It is therefore necessary to dispense with the idea of using GERS as a starting point for considering an independent Scotland's expenditure. Instead, an alternative model is proposed which starts from the UK Government's PESA statistics for identifiable spending within Scotland and initially assumes that the significant majority of this will be taken over at the onset of independence. On to this model can be added the known but unidentifiable spending indicated in GERS such as defence spending and accounting adjustments and the fiscal impact of additional public spending in Scotland resulting from the expanded government services as outlined above. From this, a more accurate estimate of Scotland's potential expenditure and revenue at the point of independence can be generated. For the purposes of calculating the deficit as a percentage of GDP the impact on GDP of additional spending within Scotland is included. When estimating an independent Scotland's initial tax revenue, the starting point is taken to be the latest figure of £53.748 billion estimated by GERS 2015-16 (which includes a geographic share of oil revenue of £60 million) on to which is added the additional tax revenue generated by the effects of the various changes outlined in previous sections.

	Scotland's budget (£mn)		
Fiscal Area	Best Case Estimates	Middle Case Estimates	Worst Case Estimates
Identified Expenditure	£55,475	£55,475	£55,475
Accounting Adjustments	£3,855	£3,855	£3,855
Defence	£700	£1,950	£3,100
Debt Interest	£750	£1,100	£2,040
Pension Liability Reduction	-£8,000	-£3,500	-£1,000
Overseas Spending	£2,400	£2,400	£2,400
Other Non-Identifiable Spending	£2,350	£2,350	£2,350
Total Expenditure	**£57,530**	**£63,630**	**£68,220**
Tax Revenue (GERS 2015-16)	£53,748	£53,748	£53,748
Income due to Defence Spending	-£200	£50	£300
Income due to Government reorganisation	£1,358	£719	£479
Closing the Tax Gap	£6,000	£3,500	£1,120
Total Revenue	**£60,902**	**£58,017**	**£55,647**
Notional Deficit (£mn)	+£3,376	-£5,613	-£12,573
Notional Deficit (%GDP)	-2.11%	**3.53%**	**7.91%**
UK Deficit 2015-16 (%GDP)	4.0%	4.0%	4.0%
Debt to GDP Ratio Scotland	**31.22**	**31.44**	**85.52**
Debt to GDP Ratio UK	89.2	89.2	89.2

Conclusions

The Scottish independence debate has been ill served by the focus up till now on GERS alone as an indication and predictor of the finances of an independent Scotland. After the considerations resulting from any transition period are taken in to account, there is clearly much that would change as a result of the decision to become an independent country. These changes would have a significant impact on the budget and financing of Scotland even before the potential opportunities afforded by the reclamation of various reserved policies can be enacted upon.

What this paper has shown is that even using modest fiscal multiplier estimates as well as very conservative estimates regarding the impact of closing the tax gap as well as reduced debt interest repayments through prudent restructuring, Scotland's deficit can be reduced by several billion pounds per year.

This paper is not intended to be the final word on this subject and all invitations to improve the work by better identifying and locating currently "non-identifiable" spending are extended and encouraged. But what it has shown is that even using modest fiscal multiplier estimates as well as very conservative estimates regarding the impact of closing the tax gap as well as reduced debt interest repayments through prudent restructuring, Scotland's deficit can be reduced by several billion pounds per year. It is possible that simply the act of independence could bring Scotland's fiscal situation to "deficit parity" with the UK, as long as the establishment of new Scottish state institutions is done with competence and prudence. That this situation can be brought about even without a discussion about increasing tax revenue as a percentage of GDP or by relying on revenues from volatile and diminishing resources such as oil, shows the fundamental economic strength in which Scotland would begin life as a new country.

Appendix (Tables in full)

Defence spending model	Defence Spending in Scotland (£mn)	Increase in Spend within Scotland (£mn)	Fiscal multiplier Effect on Revenue (£mn)	Total Savings Compared to Status Quo
Ireland (0.45% GDP)	£700	-£1,000	-£200	£2,130
EU Average (1.24% GDP)	£1,950	£250	£50	£1,130
NATO Target (2.0% GDP)	£3,100	£1,400	£300	£230

Country	Tax Revenue as % of GDP	Scottish Equivalent Tax Revenue (£mn)	Change in Revenue Compared to Status Quo
Scotland (Status Quo)	34%	£53,748	£0
UK Average	36%	£56,528	£2,780
Nordic Average	43%	£67,417	£13,669
Denmark	50.9%	£79,772	£26,024

	Scotland's budget (£mn)		
Fiscal Area	Best Case Estimates	Middle Case Estimates	Worst Case Estimates
Identified Expenditure	£55,475	£55,475	£55,475
Accounting Adjustments	£3,855	£3,855	£3,855
Defence	£700	£1,950	£3,100
Debt Interest	£750	£1,100	£2,040
Pension Liability Reduction	-£8,000	-£3,500	-£1,000
Overseas Spending	£2,400	£2,400	£2,400
Other Non-Identifiable Spending	£2,350	£2,350	£2,350
Total Expenditure	**£57,530**	**£63,630**	**£68,220**
Tax Revenue (GERS 2015-16)	£53,748	£53,748	£53,748
Income due to Defence Spending	-£200	£50	£300
Income due to Government reorganisation	£1,358	£719	£479
Closing the Tax Gap	£6,000	£3,500	£1,120
Total Revenue	**£60,902**	**£58,017**	**£55,647**
Notional Deficit (£mn)	+£3,376	-£5,613	-£12,573
Notional Deficit (%GDP)	**-2.11%**	**3.53%**	**7.91%**
UK Deficit 2015-16 (%GDP)	4.0%	4.0%	4.0%
Debt to GDP Ratio Scotland	**31.22**	**31.44**	**85.52**
Debt to GDP Ratio UK	89.2	89.2	89.2

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