

OPTIONS FOR SCOTLAND'S FUTURE: THE ECONOMIC DIMENSION

All sorts of organisations are giving their take on these issues just now: what makes the David Hume Institute special is that it has no political bias, and simply looks at the evidence base objectively, analytically and indeed sceptically.

The large and distinguished audience gathered in the Playfair Library for this last seminar of the Autumn 2008 series demonstrated clearly the degree of interest in this topic. It was however remarkable, and disappointing, that no MSPs were present. It can hardly be possible, surely, that none of them are interested in an examination of the economic evidence of the various possible ways forward?

Underpinning the seminar itself has been the development (with sponsorship from Scottish Financial Enterprise for which the DHI is most grateful) of a major piece of research covering economic aspects of the possible paths to further devolution, including fiscal devolution, or independence. This substantial paper has now been published on the DHI website, with contributions from Andrew Hughes Hallett, Professor Drew Scott of Edinburgh University, Fabian Zuleeg and Jeremy Peat and Lesley Sutton of the DHI.

Inevitably the two presentations, by Fabian Zuleeg and Andrew Hughes Hallett, had to focus on the key emerging messages from this work: we shall need to read the full paper to appreciate the detailed analysis on which these are based. "Read it tonight!" Andrew Hughes Hallett urged the audience: well, I confess that I didn't but I intend to do so very shortly.

The Chair was Brian Taylor, Political Editor, BBC Scotland. Brian last Spring gave us a characteristically shrewd analysis of "the unfinished business of devolution" in which current funding arrangements figured prominently, so he was the ideal person to steer the seminar.

Fabian Zuleeg opened the innings with an overview of what we know about existing government expenditure and revenues in Scotland. He drew out three crucial issues that have to be taken into account in any consideration of changes in funding arrangements.

Firstly, he emphasised that the GERS analysis is "as close to fact as we can make it" but that it is irreducibly a matter of **assumptions as well as facts**. This is not just the academic's usual disclaimer. It is fundamentally important in considering any changes in funding to appreciate that there is a significant margin for error in the current analysis. That analysis shows a consistent gap of about 10% between Scotland's revenues and Scotland's spending.

Secondly, he elegantly demolished some of the more optimistic political assumptions as to the **scope for oil revenues** to plug that gap. If Scotland were to secure its maximum share of oil revenues based on geography (and the political likelihood of that does not look high), this would at best reduce the gap from 10% to about 4%. (This is where the previous point about margins

of error becomes so significant.) Recent sky-high oil prices could boost investment in Scottish oil production and thus close the gap and indeed turn deficit into surplus in the short term, but it would not just be brave but suicidal to base funding structures on the hope that such high prices could be the norm. In any event, the volatility of oil revenues would need to be taken full account of in funding arrangements. Finally on this aspect, he pointed out that oil revenues could either be used to help plug the revenue gap **or** to create an oil fund but not both.

His final main message was that there will be **no escaping difficult choices**. The 10% gap will not dissolve itself and whatever funding mechanisms are chosen they will have to deal with it.

That theme of difficult choices was carried through into the second presentation by Andrew Hughes Hallett, who set out the pros and cons of various alternative funding options. All the options he examined were being implemented somewhere in the world. His key message was that there was **no one best scheme** that emerged from the analysis. Each involved trade-offs eg as to operational simplicity, stability, incentivisation, social equity etc. So fundamentally it comes down to political choices as to which of these factors are most important. But it is nonetheless valuable that such choices are informed ones and that the implications of the various models are well understood.

The specific options that he examined were: **block grant** (either the status quo or a revised version of it which still made up the deficit from UK funds) which would be stable but conceptually flawed in not linking inputs to outputs; **assigned taxes** which would be operationally difficult to do unless on an apportionment basis which would conceptually be a minimal improvement on the status quo and would add volatility problems which would require borrowing powers to smooth; **fiscal federation** which was not easy to see happening in current UK political circumstances; **partial fiscal autonomy** on the US States model; **full fiscal autonomy** within a single political union on the Channel Islands model; or **independence**. Overall, this represented a broad spectrum from models which maximised stability of funding base to models which maximised close linkage between what we raise in taxation and what we spend.

In response to the obvious question from Brian Taylor, Professor Hallett said that both personally and professionally he preferred the independence end of the spectrum but that he recognised that this was a personal preference.

All of this gave much food for thought; and the discussion which followed the presentations was notably reflective. The main themes emerging were:

- Perhaps after all the status quo has fewer risks? But others felt that the lack of connection at Scottish government level between income and expenditure was a fatal flaw.

- For many in the audience, the crucial thing was to have a funding system that promoted economic growth. But is there clear evidence that increased fiscal autonomy leads to economic gains? The Spanish example was cited, but others felt that this is a long way short of demonstrating causality.
- A number of contributors highlighted that decisions were essentially about political choices not economic technicalities; and also the need for greater political engagement in the debate. The “Panglossian” attitude of the UK government that the current settlement is all for the best in the best of all possible worlds was particularly criticised.
- Some contributors stressed that further change is bound to happen; and thus that it is crucial to ensure that this is so far as possible evidence-based rather than rhetoric-based.

So where do we go from here? In the immediate future, clearly we await the first outputs of the Calman Commission early in the New Year. But the reaction on the night from the audience made it clear that there is scope for the David Hume Institute to continue to contribute analytic thinking to the ongoing debate.

My own personal reaction? I came away with two thoughts:

- Surprisingly (to me at least), the evidence presented gave me a firmer appreciation of the benefits of the status quo or some modification quite close to it: the risks and uncertainties of other options were brought forcibly home to me;
- Conversely, reminiscing in conversation about the 1997 devolution settlement with former colleagues who also played a part in making it happen, I was struck by how far we have moved on since, how much of what was then unthinkable has become thinkable and how much of what was then impossible has become possible. So yes I do agree with Brian Taylor that the status quo cannot be the final word.

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