THE DAVID HUME INSTITUTE

Report on the ECONOMIC ASPECTS OF POLITICAL INDEPENDENCE

Hume Occasional Paper No. 56

The David Hume Institute
21 George Square
Edinburgh EH8 9LD

c The David Hume Institute 1999

ISBN 1-870482-57-3

Report on the Economic Aspects Of Political Independence*

David Simpson,
Brian G M Main,
Alan Peacock,
and
Fabian Zuleeg.

THE DAVID HUME INSTITUTE

1999

*The Sponsorship of MacDonald Orr Ltd. is gratefully acknowledged.

Foreword

This Hume Occasional Paper examines the prospects for the Scottish economy of moving from devolution to independence. This is a topic that is generating an increasing amount of discussion, and with the elections for the Scottish Parliament in May 1999 interest in the implications of such a move is rising by the day. The analysis presented in this paper attempts to lay out the issues that are likely to arise in such a move and to examine the likely impact on the economic prosperity of Scotland. The arguments for and against independence run far deeper and wider than the economics of the matter, but these other considerations are left to others to address. Financial support for this research was provided by MacDonald Orr Ltd. to whom the Institute is most grateful. As always, it is necessary to clarify that neither the sponsor nor the Institute itself hold any collective view on these policy matters.

Hector L MacQueen and Brian G M Main
Directors
April 1999

Authors:

David Simpson	is Honorary Professor of Economics at Heriot-Watt University and a Trustee of The David Hume Institute
Brian Main	is Professor of Economics at the University of Edinburgh and Research Director at The David Hume Institute
Sir Alan Peacock	was the first Executive Director of The David Hume Institute. His previous experience in constitutional matters includes being a member of the Royal Commission on the Constitution (Kilbrandon) (1971-73) and Chief Economic Adviser, Department of Trade and Industry (1973-76)
Fabian Zuleeg	is a PhD student in Economics at the University of Edinburgh

Economic Aspects of Political Independence

CONTENTS: page

Preface i

Executive Summary i

1. Introduction 3

2. The Underperformance Of The Scottish Economy 4
   Background 4
   Possible Reasons for Scotland's Underperformance 5

3. Economic Aspects Of Dependence 8
   The Fiscal Balance Issue and the Barnett Formula 9
   The Present State of the Public Finances 11
   A Poisoned Chalice? 12

4. Economic Aspects Of Independence 13
   The Irish Experience 14
   What Freedom Of Policy Choice? 17
   Lessons For Scotland 18

5. Questions Of Transition 19
   Uncertainty And Business Confidence 19
   The EU and EMU 20
   The Public Sector and the Move Towards Independence 22

6. Conclusions 25

Endnotes 26

Bibliography 27

Statistical Appendix

Executive Summary :

1. A move from devolution to independence would be a political decision based on a wide range of considerations. The economic dimension of the move may therefore be only one factor amongst several that will govern public perceptions of its value.

2. Since the First World War the performance of the Scottish economy has lagged that of the UK as well as that of other Western European countries of comparable size and location. This suggests both the inadequacy of past policies and the scope for future improvement.

3. The performance of any market economy at any time depends on a number of factors, most of which are outside direct political control. Government policy can enhance economic performance by providing a fiscal, regulatory and psychological environment that is sympathetic to business and conducive to its success.

4. The present system of regional disbursement of central government funds through a block grant system which is unrelated to the fiscal resources of a region provides few incentives or opportunities for innovative economic policymaking at the regional level. It puts Scottish civil servants in the position of being judged by the public according to their ability to maximise funding from central government rather than according to their skill in its efficient allocation. The funding arrangements underpinning the current devolution proposals are unlikely to remedy this situation because they perpetuate fiscal dependence on central government. They also come at a time when the block grant from central government will be constrained by the Barnett formula, and this is likely to increase tensions between the Scottish Parliament and Westminster.

5. A devolved Scottish Parliament has aroused widespread expectations that it can bring about an improved performance in the Scottish economy. These expectations are likely to be disappointed, since the Parliament has very limited powers over economic policy, only modest control over the size of its own budget, and only restricted relations with Europe.

6. The difference between devolution and independence from an economic point of view is that independence necessitates moving from a culture of dependence towards a culture of self-reliance and at the same time gives access to a wider range of policy instruments. Independence will not by itself lead to an improved economic performance, but such an outcome is more likely if lessons are learned from the experience of comparable countries.

7. An independent government in Scotland that paid due consideration to the economic issues that we have outlined might reasonably be expected to be able to pursue economic policies that would give Scottish businesses and institutions the right incentives to improve their performance. However, independence will not spring up overnight and a clear indication of the path towards it must be given which pays particular attention to economic measures that maintain the confidence of inward

investors and the large financial sector. Not to do so could lead to a decline in support for independence itself.

ECONOMIC ASPECTS OF POLITICAL INDEPENDENCE.

1. **Introduction**.

This paper is an attempt to tackle the difficult task of determining how a move from devolution to independence in Scotland is likely to affect the economy. It does not take a position on whether independence is good for Scotland which can only be derived from personal value judgments. However, such judgments must depend in large part on what we can discover about the likely economic situation that will face Scotland as a result of a major change in its mode of governance.

The process of discovery is not an easy one. In particular, account has to be taken of the growing extent to which the major economies of the world are becoming closely inter-linked so that national governments have limited control over economic forces. Any scenario about the future of the Scottish economy must not only take account of external influences which are difficult to identify and appraise but also look carefully at the evidence regarding the effect of government actions designed to promote economic advance. In devising such a scenario we have been helped considerably by the impressive amount of published empirical economic research presented to the public by (mainly) Scots economists to which we have added some of our own by further data collection and by those interviewed. (See also Bibliography below.)

Those with strong opinions on the value of independence will interpret this evidence in different ways. If there is any lesson to be learnt from its examination, it is that one must be circumspect in how one uses the evidence for economic forecasting. We cannot avoid prognosis but contend that we know what can reasonably be inferred from our knowledge of the present state of the Scottish economy and its links with the outside world.

The argument of this paper may be stated as follows. The Scottish economy continues to lag behind that of the UK and comparable neighbouring economies. There have been recent signs albeit transitory of improvement, but Scotland still performs less well than some other regions. An improvement in this situation is best achieved by creating a climate friendly to business enterprise. The case for a devolved system of government leading to eventual independence is that it could be a way to engender an improvement in business confidence and in the efficient allocation of resources within the public sector itself, although other, more prosperous, regions have so far not deployed similar arguments to the same extent. The claim is made that, for Scotland at least, control over its own economic policies is essential in order to create the environment which will engender the necessary spirit of self-confidence in its economic future and also improve public understanding alongside public participation in the decision-making process. In general, we believe that this claim is a reasonable one though it clearly depends on the right policy choices being made and the recognition of the growing openness of advanced economies which limits the policy options.

At the turn of the century, Scotland was at the height of its economic powers, and government intervention in business affairs was minimal. Today, after a hundred years of absolute progress but relative underperformance, the prosperity of the Scottish economy is a matter for which Government is assumed to be ultimately responsible. Policy is therefore a central issue. With the advent of devolution, Scotland will enjoy an increase in political accountability with regard to spending of the Scottish Block Grant but in other ways will remain a dependent region: that is, major questions of economic policy will be still be decided outside the region. In the third section of the paper, we discuss some aspects of this outcome, paying particular attention to public policy and the public finances.

In trying to understand the economic aspects of independence, it seems sensible to look at the experience of countries that are already politically independent and are comparable in their size, trading arrangements and political institutions. In making such comparisons, we should not lose sight of the fact that there remain significant differences in history and culture. The comparator countries we have chosen are Denmark, Finland, Ireland and Norway (see Table 7e). Although Norway, like Scotland, has reserves of oil and gas offshore, it is Ireland that resembles Scotland more closely than do any of the others, in particular in the recent history of its economic relationships with England. It is this question of economic relations with England which is among the most important in any consideration of the economic aspects of Scottish independence. We have therefore chosen the Irish experience for closer examination, in the fourth section of the paper, to see what lessons may be learnt for Scotland.

Almost as important as the state of independence itself are the questions which are raised by the prospect of getting there from here. Such a process of transition involves great uncertainties and uncertainty is generally seen as being bad for business. In section five, we review some questions of transition. In particular, Scots voters weighing-up the prospect of independence are understandably anxious to know how it will affect their pocket. While some assessment can be made of the likely state of the public finances at the point of changeover, the budgetary situation of an independent Scotland will depend on the long run performance of the economy. Conclusions are drawn in section six.

2. The Underperformance of The Scottish Economy.

Background:

The story of the Scottish economy in the twentieth century is a story of relative underperformance. While the UK has generally underperformed the European average, for most of the century the trend rate of growth of Scottish output has tended to fall below the long-term UK rate of GDP growth of 2% per annum, (Lee, 1995).

The earliest estimate of GDP per capita[1] for Scotland is for 1924. In that year the Scottish figure was about 96% of the corresponding UK number. Preliminary latest estimates for GDP in the UK regions were published at the beginning of February and

are reported in Table 1c. They show Scottish GDP per head in 1997 was 95.5 % of the UK level, almost identical to the earliest 1924 estimate. As is demonstrated in Chart 1 (extending Ashcroft, 1997, Figure 1), Scotland's relative position in terms of per capita GDP has fluctuated over the years. Following an absolute as well as relative decline from 1928 to 1932, there was a war-time revival, producing an 8% annual growth rate from 1938 to 1948. In the post-war period, Scotland has enjoyed a growth rate of GDP rather less than that of the United Kingdom, with phases of relevant improvement as from 1963 to 1976 and the early 1990s, and some comparatively weak phases, as in the 1950s, the later 1970s and the mid-1980s (see Lee, 1995, for a more detailed discussion). When compared with other small economies such as Denmark, Finland, Ireland, and Norway, as in Chart 2, Scotland's economic record in terms of per capita GDP is no more impressive (see Table 7d). It seems clear that size of country and output per head are inversely related (see Table 7f).

Employment performance has been rather worse. The level of Scottish employment remained almost stationary from the First World War until the early 1970s, while UK employment grew at 0.46% per annum over the same period (Lee, 1995). Since then, employment has fallen while that in the UK and in every comparator country, except Finland, has risen (see Chart 3).

In terms of unemployment, the Scottish economy appears to have recently enjoyed a relative improvement compared with the UK average (see Charts 4 and 5). As can be seen in Table 2, Scotland on the ILO measure of unemployment stands at 7.4%, United Kingdom 6.1%. On the same measure, Norway is 3.2%, Denmark 4.6%, Finland 10.7%, and Ireland 7.2% (see Tables 2a and 2b).

One of the most significant features of the Scottish economy in the past century has been net emigration.. Continuing emigration at the rate of roughly one quarter of a million per decade, combined with a declining rate of natural increase, has arrested and, since the early 1970s, reversed the rate of population increase. As a result, the population of Scotland has fallen from 12.5% of the UK in 1861 to 8.8% in 1994. (Ashcroft, 1997). It seems not unreasonable to suppose that the emigrants that have characterised this period contained a disproportionate number of the more enterprising members of the population. The recent trends between 1950 and 1997 are illustrated in Chart 6, where Scotland's population relative to 1955 is plotted along with that for other comparator countries

Possible Reasons for Scotland's Underperformance:

While many factors may account for Scotland's underperformance, Ashcroft (1997) has argued, in our view convincingly, that one factor that links all these outcomes is a failure of indigenous entrepreneurship.

This failure is first noticeable just before the First World War. Although there are no GDP estimates for that period, there is evidence to support the belief that in the last decade before the Great War Scotland was amongst the most prosperous countries in the World. At that time, it is possible to view the Scottish economy as possessing a

strong element of independence in the sense that the economy depended neither on external financial support nor on the economic policies of central government. In those days, as elsewhere in the world, the role of national (though not municipal) government in economic activity was slight. The country's prosperity was largely founded on a complex of metal-processing and engineering industries, led by shipbuilding. Before the First World War, almost one fifth of the world's total of shipbuilding tonnage was launched on the Clyde. Despite this pre-eminence, however, there were already signs of a failure to adopt new products and new processes: while competitors were switching to marine diesel engines, Scottish shipbuilders continued to use steam (see Lee, 1971).

What was more important, was the lack of success in Scotland in establishing new industries which were beginning to displace the traditional ones. In Scotland, as elsewhere in the world, new plants sprang up before the First World War to manufacture electrical, chemical, and rubber products, cycles, motor vehicles and even aircraft. But, unlike elsewhere, almost all of these new ventures ended in commercial failure. For a while this was disguised by the upsurge in demand for the products of the heavy metal industries brought about by the War, but after the War the overall economic decline could no longer be concealed.

Significantly the indigenous entrepreneurs who still led the heavy industries in the inter-war period spurned opportunities to modernise their production processes, preferring instead to concentrate their efforts on seeking government assistance to reduce capacity, and engaging in various other defensive and anti-competitive practices (Payne, 1996). The Second World War came to the rescue of the Scottish economy: from 1938 to 1948 GDP grew faster than it did in the UK as a whole. After that War, with the election of a Labour Government and the ascendancy of Keynesian economics, people looked more to the State rather than to private entrepreneurs to secure a high level of employment.

The State responded by adopting a policy of attracting to Scotland foreign direct investment (FDI) in manufacturing, and particularly in electronics. While the employment thus provided filled a gap, in Ashcroft's (1997) words the policy treated "..the symptoms of domestic entrepreneurial weakness, and appears to have done little to remedy the cause." Indeed, Ashcroft believes that by reducing the demand for staff with professional, managerial and entrepreneurial skills it may even have diminished further the supply of potential entrepreneurs. This phenomenon, sometimes styled the branch-economy syndrome, cannot easily be substantiated, but what is clear is that there was a failure of "linkage", i.e. local suppliers have on the whole not been successful in recognising the opportunities offered by incoming industry.

It can be argued that this relative weakness of Scottish entrepreneurship has continued up to the present day. Data on the geographical incidence of significant innovations in the UK economy over the period 1945 to 1983 indicate that Scotland's share over this period averaged only 5%, placing it third bottom in the ranking of the eleven UK standard regions (Ashcroft, 1997: p24). In an EU-funded collaborative study of new product development in 1991-93, (Roper et al., 1996), 51 % of Scottish manufacturers could be classed as innovators compared to 64% in the rest of the UK, 68% in Ireland, and 72% in Germany.

So far as the business birth rate is concerned, a study of new firm formation per thousand of working population, 1980-1988, shows that the Scotland rate stood at 45 per thousand compared to 75 or greater per thousand in southern England. Only the North of England had a rate as low as the Scottish figure (Chart 7). It might be thought that Scotland had experienced a delayed reaction to the Thatcher Government's policy measures. But in an updated analysis commissioned by Scottish Enterprise from the Fraser of Allander Institute, Ashcroft and Low found that there was a slight deterioration in the Scottish performance relative to the South East between the years 1980-86 and 1990-96, although the change was unlikely to be statistically significant. These findings may, of course, suggest that Scotland has at least kept pace with the South East in a period that is generally thought to have been marked by an upturn in entrepreneurial activity.

What is the cause of the poor record of indigenous entrepreneurship in Scotland? Cultural factors have played a significant role, and "have been conditioned by Scotland's industrial, political and social experience" (Ashcroft 1997). This may be another manifestation of what some commentators have referred to as the "culture of dependence" in Scotland, which is often claimed to run deeper in Scotland than in most other regions of the UK. To be a useful explanation of Scotland's economic problems this cultural dependence must be stronger here than in other regions, as other regions in the UK suffer from the same problem, save perhaps London and the South East. And indeed these findings on entrepreneurship substantiate the informal impressions of some observers of the Scottish business scene.

Of course, the growth potential of a modern economy is not to be measured only by the birth of new businesses. Equally important is the ability of existing firms to adapt successfully to the changing environment. While there are some very obvious and genuine success stories in firms such as the Bank of Scotland, the Royal Bank of Scotland, Scottish Power, Scottish & Newcastle, Stagecoach, and one or two life assurance companies, worries are often expressed concerning the robustness of the indigenous corporate sector. This line of argument claims that compared to other parts of the UK, and most particularly compared to other regions of Western Europe, there can often be found amongst many in the Scottish business community a defensive, inward-looking mentality which resists internationalisation. Such reasoning often extends to the claim that in Scotland a can-do, go-getting attitude is remarkable for the infrequency with which it is encountered, with too many small and medium sized enterprises looking to government agencies for support.

No doubt, the origins of any such attitudes may lie in the past. Whereas other small European nations had to take risks to survive in international markets[2], our businesses enjoyed Empire and Commonwealth protection and, later, government subsidy. Globalisation and the competitive forces represented by that term provide no such shelter and place a premium on flexible, entrepreneurially-led economies. There is some evidence that labour market and product market reforms of the past two decades have indeed led to an increasingly flexible and dynamic economy in Scotland. However, there are few who would not argue that there is substantial room for improvement. The question is whether that improvement is best brought about in a unitary, albeit devolved, UK or in an independent Scotland. The following section examines the economic aspects of political dependence.

3. Economic Aspects Of Political Dependence.

A state of dependence implies that major policy objectives and instruments for achieving them are outside the direct control of any region. What is described as regional policy will be decided by the central government. Even when Scotland has its own Parliament, major policy initiatives will still require that Scottish civil servants have to be in close touch with their central government counterparts. Lacking decision making powers, regions cannot easily learn from the experience of each other. The lack of initiatives available to regions hardly encourages an interest and expertise in sensible use of scarce fiscal resources. The regional perception of 'success' in dealing with the central government is likely to be measured by the size of the budget, without offering encouragement of an interest in the efficiency in its use.

The consequences of the severing of the nexus between beneficial government expenditures and its finance were manifested very clearly in Scotland after the Second World War. When politicians invite citizens to vote for them because that will ensure the continuation of fiscal transfers which purport to improve local economic and social conditions, without having to answer questions about the source of funding, then even strenuous efforts by watchful civil servants cannot prevent misallocation of resources. The waste of money on a succession of white elephants such as the Invergordon smelter, the strip mill at Ravenscraig, the Linwood car plant, and some Glasgow housing schemes -- to mention only some of the more flagrant cases -- is obvious to all, but there is no evidence that it has curbed the enthusiasm for inward transfers on a large scale. We are bound to agree with the verdict of Sir Fraser Noble delivered long ago in a different context:

> In the result, large sums are poured into the region in various forms without any machinery being created to ensure that the expenditure is an efficient investment in the productive capacity of the region which will ultimately increase its capacity to export and/or decrease its dependence on imports. (Noble, 1951)

The demands for devolution and independence, however, focus attention on the equity and efficiency of fiscal transfers between regions. The transfer of power from Westminster to Holyrood presupposes close scrutiny of the allocation of government funds to the Scottish Parliament, a body which now has considerable power over how these funds are to be used. The equity issue is raised by the relative allocation to Scotland compared with other parts of the United Kingdom and the extent to which this allocation entails a counterbalancing revenue derived from Scottish sources. The efficiency issue concerns the extent to which an inevitable link has to be established between the transferred funds and the source of their finance, and puts pressure on the devolved governments to improve their methods of appraisal of the programmes that they must now devise for themselves. In the case of devolution alone, there are already signs that central government, in particular the Treasury, will insist on a role in programme appraisal. In the case of independence, a major change in the culture of the Scottish civil service would be called for, given that the responsibility for efficiency now falls squarely on their shoulders. A fiscal deficit would no longer be the product of an administrative convention, but would become a hard constraint (see McGregor

et. al., 1996). The need for such change would soon be apparent if funding for economic advance were sought from international bodies such as the European Union (EU) or the World Bank.

The necessary change in culture has been clearly demonstrated in the Republic of Ireland's relationship with the EU. The EU has been a major source of investment in infrastructure (see Table 4c) and the Irish government has had to draw up programmes giving a clear idea of costs and benefits which demonstrated the quality of additionality, i.e., the activities supported by funding would not otherwise have been undertaken. The EU also made it clear that continuous funding was not in prospect. Of course, the significant growth achieved by the Irish economy in the 1990s is the result of a number of factors, as we explain below, but there can be no doubt that the methods of appraisal and monitoring of the infrastructural investment programme made a significant contribution. This was only made possible because governments and their officials realised that accountability had to become the keystone of a successful long-term policy, particularly if long-term capital for both private and public ventures is to continue to be attracted. The contrast with Northern Ireland could not be greater, where a slackness in meeting EU funding conditions indicates how far attitudes must change if and when its Government gains more responsibility for its own affairs[3].

The Fiscal Balance Issue and the Barnett Formula:

The present debate on the economic success or otherwise of independence has concentrated on the issue as to whether the level and growth of government spending desired by a Scottish government would be consistent with the willingness of its electorate to face the financial consequences. It is for this reason that the debate has taken as its starting point the attempts made to work out Scotland's present fiscal balance, i.e., the difference between the tax at present raised in Scotland and central expenditure within it.

The fiscal balance issue is only one element in any assessment of how the Scottish economy would fare under an independent government. Consequently, the present debate is a rather sterile one if it is confined to disputes about whether the balance is positive or negative. Be that as it may, attitudes to devolution and independence must colour the approach to such calculations. Therefore, we are required to explain in some detail the origins, nature, and significance of the fiscal balance problem.

Prior to 1978, the flows of public expenditure to and tax revenues from Scotland were shrouded in mystery. Then, as now, about half of all government expenditure in Scotland passed through those Departments for which the Secretary of State has responsibility. It is this half of government expenditure on which all subsequent attention has focused, the remainder still being shrouded in mystery. Then as now no connection was made between the amount of revenue raised in Scotland and the amount of public expenditure devoted to Scotland. The amount of public expenditure coming to Scotland through the Secretary of State's Departments before 1978 was negotiated annually on an individual departmental basis. At that time, the

Treasury was itself divided into segments corresponding to the Departments with which it was negotiating. No official view was taken of the aggregate of expenditure of the Secretary of State's Departments as a whole. The earlier Goschen formula seems to have been neither regularly nor universally applied (Bell at al., 1996).

When the first overall assessment was attempted in anticipation of the Devolution Bill of 1979, it was discovered that the public expenditure in Scotland which passed through the Secretary of State's departments was some 25% greater, per head of population, than in the corresponding English Departments. In some expenditure categories, such as Health and Education, the difference was even greater. This outcome was generally recognised to be the result of the excellent negotiating skills of civil servants in the Scottish Office.

This prompted a "needs analysis", i.e., an assessment of the relative costs of delivering the same level of public services in the four countries of the UK. The study concluded that around 15% of extra spending per capita in Scotland might be justified on the basis of "need". This still left an unexplained excess of expenditure in Scotland's favour. Furthermore, the exercise showed that the assessment of need was necessarily subjective, and therefore largely political (Constitution Unit, 1996, p.73). It is perhaps significant that successive Secretaries of State down to the present have resisted periodic appeals for updated assessments of "need".

In 1978 the then Chief Secretary to the Treasury, Joel Barnett, sought to solve the problem by devising a formula which when applied over time would gradually reduce the relative excess of expenditure in Scotland. The formula was quite simple: henceforth, that part of public expenditure in Scotland which passed through the Secretary of State's Departments (roughly, the "Scottish Block") would increase, per head, by exactly the same amount as did the corresponding block of expenditure in England. So if the total of expenditure of the corresponding English departments increased by £100 per head, so the Scottish "Block" grant would increase by £100 for every resident in Scotland. Since Scotland was starting from a higher base, this equal absolute annual increment would mean a smaller percentage annual increment in Scotland, and thus would lead to a gradual convergence of levels of public expenditure per head in the two countries. Strangely, this formula devised to bring about convergence was widely believed to entrench the Scottish differential, and this belief is still held today by many otherwise well-informed people on both sides of the Border.

The Barnett formula not only had the merits of simplicity and gradualness, but it removed the Scottish Block from the annual haggling which took place between the Treasury and the other spending departments in England. Had it been implemented as intended, then the imbalance in Scotland's favour in certain categories of public expenditure would by now have been eliminated. However, as a result of the coincidence of a number of factors, which Heald (1994) has christened the "Barnett By-Pass", its implementation was delayed, and the position of the Scottish public finances remained broadly unchanged, (Kay, 1998). These factors included the opacity of the corresponding English baseline, a failure to adjust for relative population changes, and a willingness to implement public sector pay increases on a UK-wide basis regardless of the formula. However, in 1992 when Michael Portillo was Chief Secretary, these loopholes were closed one by one, so that on the eve of the

implementation of the second Devolution Bill, the Barnett formula has already begun to be strictly applied. If adhered to, it would be more appropriate to label it the "the Barnett Squeeze" (see Bell et al., 1996). Recent analysis by Gavin McCrone (1999) spells out in some detail just how severe this squeeze is likely to be.

The Present State of the Public Finances:

In the run-up to the 1992 General Election, the Government issued a document entitled "Government Expenditure and Revenues in Scotland" (GERS). An updated version appeared in October 1995, and it has been issued annually ever since. The latest version is GERS 1996-7, (Scottish Office, 1998). As the title suggests, it is an attempt to draw up an income and expenditure account for Scotland. Unfortunately, since 1992 no attempt has been made to improve the quality of the data, admitted to be less reliable than corresponding data for the UK, nor to address the weaknesses of the methods of estimation adopted at the outset, (Cuthbert and Cuthbert, 1998b). Expenditures recorded in the account are a mixture of expenditure which takes place in Scotland, and expenditures which are deemed to benefit Scotland. On the other side of the account, there are serious unresolved problems in allocating the revenues from corporation tax. For example, the corporation tax paid by Scottish mutual life assurance companies appears to be attributed to the region of residence of their policyholders. The Cuthbert analysis demonstrates that GERS does not achieve its declared objective, and certainly does not live up to the claim that the GERS report makes of "providing a strictly factual contribution to public understanding of the budgetary issues in Scotland. The report examines circumstances and data, using a methodology which is analytically sound and which can be clearly explained." Nevertheless, it does provide a very rough indication of the current state of the fiscal balance. Our analysis of the GERS figures (shown in Table 6c) suggests that in 1996-97 Scotland's fiscal deficit amounted to some 6.5% of GDP once Scotland's share of oil revenues is included.

In any country, the fiscal balance, being the difference between two quite large numbers, is notoriously volatile, and year to year changes are difficult to predict. For example, in its November 1997 Pre-Budget Report the Treasury forecast that 1997/98 public sector borrowing in the UK would be £9.5 billion. The actual out-turn was £1.1 billion (Chennells and Dilnot, 1999: p.121). The annual fiscal balance in Scotland over the last two decades has been influenced very largely by the extent to which the continuing "excess" expenditure in such categories as health and education is offset by North Sea tax revenues. As Kemp and Stephen (1999) show, the time pattern of tax revenues attributable to the Scottish sector has also been extremely variable, reaching a peak of around £10 billion in the early 1980s, and falling to below £2 billion in 1998. When the cumulative fiscal balance is calculated over all of the years from 1979 to 1995, using the GERS methodology, adding in the Scottish share of the oil revenues, and the Treasury's calculation of the Scottish share of the annual UK fiscal deficits, the result is a Scottish "surplus" of around £ 30 billion[4]

A Poisoned Chalice?

The establishment of the Scottish Parliament has raised widespread expectations of an improved economic performance. Although this may indirectly be a possible outcome if there were to be an associated increase in the level of business confidence, the Parliament possesses only two powers which will have a direct impact on the economy. One is the power to alter the composition (but not the total) of public expenditure, and the other is the power to vary within strict limits the basic rate of income tax. Neither significantly diminishes the level of dependence of the regional economy.

In principle, the Parliament could have been given greater fiscal freedom, for example, by having the responsibility to raise all its own taxes and, out of these revenues, to make an agreed contribution to the common UK expenditure. But this could have produced a chain reaction of demands by English regions for similar powers. Instead, the primary mechanism for determining the funds available to the Scottish Parliament is likely to be the Barnett formula. The extent of the Barnett "squeeze" can be illustrated by Cuthbert and Cuthbert's (1998a) calculation that if the Government were to decide that there should be an x% increase in overall public expenditure in England, funded by equal percentage increases in council tax and in Government support to local and central programmes, then the percentage increase in the Scottish Block will be approximately 0.81x%. Unless other programmes within the Block are squeezed, the percentage increase in Council tax in Scotland required to achieve the same percentage increase in total funding for local authority current expenditure as in England would have to be almost 2 ½ times that in England.

According to Barnett, real growth of 2% per annum in public expenditure in England (as anticipated in the Government's expenditure plans announced in 1998) together with inflation of 3% would result in real growth of about 1 % in public expenditure in Scotland (Cuthbert and Cuthbert, 1998a). On the other hand, if there were no real growth in public expenditure in England, and inflation at 3%, then the Barnett formula lead to a cut in real terms in public expenditure in Scotland of about £84 million cumulatively every year. If that were to happen, the Parliament would find itself under strong pressure to use its powers to increase the tax rate, not to improve public services, but just to offset the continuing squeeze it would suffer on its budget.

Whether this would produce the required extra revenue would depend on the effect on the tax base, and opponents of devolution have pointed towards the dangers of the adoption of an English domicile by persons and firms which could result in its reduction. This is not an unreasonable supposition, but it is important to note that it could not be remedied to the advantage of the Scottish budget if the power to lower the income tax rate were used in the expectation that this would increase the size of the tax base and produce the extra revenue needed. Since all taxes are collected directly by the Inland Revenue, any increased revenues would simply disappear into the Inland Revenue's pool. Since the Revenue does not appear to entertain the possibility of an increased yield arising from a reduced rate of tax, the Parliament's budget would be reduced by the Revenue's assessment of the hypothetical losses it would suffer from the reduction in the rate. Not only do the fiscal arrangements for the devolved

Parliament fail to restore any link between overall expenditure and overall revenue in Scotland, they actually bind the Parliament with perverse incentives.

This power is further limited by a number of other considerations. As Bogdanor (1998) has pointed out, the size of the Scottish Parliament's budget will be determined by the decisions of English spending Ministers. Most of that budget will of necessity be allocated to public sector pay. If wage agreements in the public sector are determined at a UK level, or if UK-wide standards are set for levels of service in health or in education, there may be little scope for devolved decision-making.

A further limitation concerns the operation of the system for paying housing benefits. Before devolution, the liability for local council taxes of those on housing benefit was paid by the DSS. Thus when councils raised their tax rates, they effectively "exported" the consequences to the budget of central government. After devolution, however, any such increases in housing benefit will be charged to the budget of the Scottish parliament, even although Social Security is a "reserved" function.

The borrowing powers of the devolved Parliament are severely restricted. The Scotland Act rules out any long term borrowing power "even to the extent that it is at present allowed to local authorities" (Fraser et. al., 1998).

If nothing else, our survey of the issue of the fiscal balance draws attention to the gulf separating the practicalities of devolutionary finance and the major fiscal changes that would be required to give effect to the aspirations of supporters of independence. At the same time, as we repeatedly emphasise, the central issue of the economic viability of an independent Scotland cannot be addressed by concentrating on fiscal arrangements alone, important though these must be. This entails moving to a broader canvas in which the position of an independent Scotland within the international economy is clearly delineated.

4. The Economics Of Independence.

In examining what happens when an economy moves from being a region to being a sovereign state, it is instructive to compare contemporary Scotland with a comparably circumstanced country which is politically independent. The obvious comparators, in terms of size and location, are Ireland, Denmark, Finland and Norway. Of these, the one most closely resembling Scotland in its economic circumstances is Ireland. Until 1961, the Irish economy could justifiably be regarded as no more than a poor backward agricultural region of the UK economy. In that year 77% of its exports went to the UK (Baker, 1997), its currency was fixed to sterling (until 1979), and external flows of labour and capital were almost exclusively directed to and from the UK.

Less than forty years later, the Irish economy is a developed industrial region of the European economy. In 1996 less than 25% of its exports went to the UK while 47% went to the rest of Europe (EU plus EFTA[5]). Its GDP per capita is converging on the EU average, having overtaken both Scotland and the UK on this measure of output

(see Table 7d), although Table 3 highlights the difference between GDP per capita and GNP per capita measures. How has this transformation come about?

The Irish Experience:

The following section draws heavily on recent scholarly interpretations of the Irish experience by Baker (1997) and by Bradley et. al. (1997).

It is generally agreed that no single factor explains the sustained high growth of the Irish economy in recent years. Rather, growth has resulted from the mutual interaction of six factors: (i) the changing demographic structure; (ii) the increase in human capital; (iii) the openness of the economy; (iv) investment in infrastructure; (v) economic policy; and (vi) a climate of social and business confidence.

(i) Irish demographic trends are currently quite different from the European norm, and they are not a factor that can be replicated in Scotland or elsewhere.

(ii) Free secondary education was not introduced in Ireland until 1967, since when participation in secondary and third-level education has grown steadily so that it is now above the European average. The contribution of this factor to economic growth can be interpreted as a "catching-up" process with most other European countries, including Scotland, which achieved comparable increases in human capital much earlier.

(iii) The key events in opening up the Irish economy from its inward-looking position in the 1950s were the Anglo-Irish free trade agreement of 1965, accession to the EC in 1973 and the formation of the Single European Market in 1992. Even by small-country standards, the Irish economy is exceptionally open, in terms of trade, capital flows and labour force movement. In 1996, exports were 91 % of GNP and imports 79%. In 1993, the foreign–owned share of manufacturing was 55% in terms of output, and 41% in terms of employment. The main factors attracting foreign direct investment include EU membership, skilled labour availability, and low corporate taxation.

(iv) Large-scale investment in the 1970s and 1980s provided high-class telecommunications and excess electricity capacity, but in the later 1980s roads, ports and sewerage systems became increasingly out of date. EU aid, especially European Structural Funds, between 1989 and 1999 made a further significant contribution to investment in both physical and human capital, estimated to add between one and three percentage points to the long run supply potential of the economy. Bradley et al. (1997) believe that even more important than these relatively modest quantitative benefits has been the introduction of long term planning of investment projects engendered by the European Structural Funds process (see below).

In the 1990s, European Community Structural Funds accounted for about a third of Ireland's gross receipts from the EU, the rest being CAP funds (see Table 4c). Ireland's net receipts from the EU have averaged less than 5% of GDP annually since

accession in 1973, a smaller proportion than the transfers to Scotland from the UK Government. (see Table 4b).

(v) For our purposes, the discussion of economic policy in Ireland can be divided into industrial policy and macroeconomic policy.

(a) Industrial policy:

The core industrial policy in Ireland of creating new employment opportunities (to replace foreseeably declining employment in agriculture) by attracting inward foreign direct investment in manufacturing (mainly from the culturally compatible United States) was set out in a 1958 White Paper. As with education and infrastructure, industrial policy is a long-term strategic factor which is now delivering the fruits of decades of application. (For example, inward investment in electronics in the 1970s produced domestic spin-offs in the 1990s). The four main characteristics of industrial policy have been consistency, focus, realism and the tax structure.

> Consistency: Since its inception in 1960, industrial policy has evolved without sudden shifts in objectives or measures when governments have changed. Long-term commitments on profit expatriation and taxation have been honoured in full.
>
> Focus: the policy has focused increasingly on attracting firms in specific sectors –electronics hardware, components and software, pharmaceuticals, health-care, financial and tele-services.
>
> Realism: the policy focus is related to the perceived strengths of the economy, namely education, language, telecoms infrastructure and the environment, and avoids its weaknesses of high transport costs, a scattered population and the small domestic market.
>
> Tax structure: the principal inducement is the discretionary rate of corporate taxation, available at 10% in manufacturing and some traded services. These tax rates also apply to indigenous firms in the same sectors. Although capital grants are still offered, they have declined in real terms and in relative importance.

The results of this policy were that between 1975 and 1995 employment in foreign-owned firms rose by approximately 43 per cent, while employment in Irish-owned firms fell by around 14 per cent. Although total employment in manufacturing fell by 3.2 per cent over the same period, the overall growth in employment in "promoted" sectors (i.e. manufacturing plus internationally traded services) increased by 5.3 per cent (Ruane and Gorg, 1997). There has been a significant shift in the composition of foreign direct investment since the 1960s. In addition to the increasing share of employment in internationally traded services, within manufacturing there has been a shift from traditional industries dominated by UK-owned companies towards high-tech sectors dominated by US-owned companies.

(b) Macro-economic policy:

In Baker's (1997) words "macro-economic management was indifferent for much of the 60s and 70s, disastrous from 1978-1982, well-meaning but ineffective from 1983 to 1986, and consistently effective from 1987 to date." Since 1987 good macroeconomic management has been the key to unlocking the benefits of the earlier long-term educational and industrial policies.

While the rest of the industrialised world responded to the 1979/80 oil price rises with tight monetary and fiscal policies, Ireland adopted an expansionary stance. The result was a significant increase in the rate of inflation and a very large deficit in the balance of payments. The damaging experience of the mid-1980s led directly to the development of a consensus between the political parties, the trades unions and employers on an economic strategy to restore the public finances and improve competitiveness. Subsequent national agreements involved a formal trade-off between moderate pay increases and reduced effective rates of personal taxation. These incomes policies were successful in their objectives, in large part because they reduced uncertainty in the minds of businessmen who were able to estimate their wage costs up to three years ahead, thereby increasing employment, and also because they reduced social strife. It is less certain that the wage rate outcomes over a period of years were different from what would have been established by market forces.

Success was also aided by two historical accidents. The first was that the period of necessary fiscal contraction was followed by a period in which there were booms in the UK (the Lawson boom) and Germany (reunification). The second historical accident was the co-operation of a trade union leader, Peter Cassells, with a strong personality. While the consensus between the political parties on this strategy still appears to be holding, union leaders are finding it increasingly difficult to convince their members of the benefits of the strategy.

The correction of the public finance imbalances, the ongoing process of institutional reform, the climate of political and social consensus in relation to medium term economic strategy and the consistency of industrial policy all helped to foster a stable macroeconomic climate within which business and entrepreneurship was able to flourish. Such stability remains crucial for the sustainability of the current growth performance (Bradley et. al., 1997: p6).

It would seem that a process of self-sustaining growth (i.e., a process which can survive the withdrawal of inward fiscal transfers) is under way in Ireland, since the factors which brought about the rapid growth of recent years are still in place. In the absence of a major global recession, it is reasonable to expect growth in output and employment to continue (see Tables 5a and b).

The scaling down of European Structural Funds from next year will lead to a reduction in the fiscal stimulus, but the trend in the public finances should permit a greater share of domestic funding for such infrastructural investment. There should also be an offsetting monetary stimulus coming from the removal of the traditional differential between Irish and continental interest rates as a result of EMU.

(vi) A further ingredient in recent Irish economic growth has been a climate of social and business self-confidence. Confidence is difficult to define or measure, but it nevertheless seems an important factor in economic performance, and its different strands have tended to reinforce each other in the Irish experience. Accession to the EU, enabling an escape from an introverted Anglo-centric vision, a number of capable Irish EU Commissioners, the presidency of Mrs Mary Robinson, and the development of the peace process in Northern Ireland have all helped to increase self-confidence, with a concomitant rise in willingness of businesses to invest and to recruit more staff (Baker, 1997).

What Freedom of Policy Choice?

The foregoing illustrates some of the policy choices which have been made in Ireland over the last 40 years. These are evidently different from those which took effect in Scotland where such policy choices are largely made at the UK level. But what freedom does Ireland really have?

First of all there is the freedom to choose one policy objective rather than another. Society may choose for example to give priority to numbers employed rather than income per employee. In Ireland, capital is taxed at a relatively low rate and labour at a relatively high rate: this is the result of a political consensus. Eventually it is hoped the economy will grow out of the need for a high rate of personal tax. (High personal taxation has not recently been judged a popular policy option in the UK, but the SNP proposal to attempt to use the Scottish Variable Rate power to restore the 23% basic rate of income tax (thus reversing or annulling Chancellor Brown's announced reduction as of April 2000) would place before the voters in the Scottish Parliament Elections on 6 May 1999 a test of this view.)

Irish membership of EMU means giving up an instrument of economic policy traditionally characteristic of sovereignty, namely control over the domestic money supply and hence interest rates. But Irish monetary sovereignty has always been severely constrained. Since 1979, interest rates were effectively controlled by the Bundesbank, and prior to that by the Bank of England. The advent of EMU has been a major gain to Ireland in permitting lower interest rates. The risk premium on Irish currency borrowing was previously around 2 percentage points. This is true to a lesser extent for other small countries. The reason is that for the lending banks the cost of acquiring the necessary information about the currency of the borrower is high. The main cost to Ireland of joining EMU is the exposure to fluctuations against sterling, with the short-term risk of a loss of jobs. There is also the risk of asset price speculation, which has to be addressed with fiscal measures instead of monetary ones.

Within an overall budget determined by political constraints, it is possible to vary the composition and the rates of individual taxes. There are, of course constraints on fiscal autonomy. When tax rates on alcohol, tobacco and petrol were sharply increased during the fiscal crisis of the early 1980s, purchases were switched at the margin to Northern Ireland. Nevertheless, the freedom to vary rates of personal income tax selectively has permitted a distinctive policy of attracting writers and

artists, while the freedom to vary rates of corporation tax, also selectively, has been critical in particular in attracting high-tech firms where patent protection means high profits in the short term. It has also helped more recently in building up an infant financial services industry. These freedoms meant that appropriate taxes and tax rates can be chosen to fit a coherent economic strategy.

By contrast, in a dependent region like Scotland, the Scottish Variable Rate (SVR) of income tax seems to have been chosen for a mixture of political and administrative reasons rather than because it fitted into an identifiable strategy for economic development better than any alternative instrument of taxation. In fact, the choice of the SVR could be taken as evidence of the absence of an overall strategy for economic development in Scotland.

Lessons for Scotland:

It is clear that there is no simple causal relationship between political independence and economic progress. After all, Ireland became effectively independent in political terms as long ago as 1922. Nor is independence a guarantor of wise or successful economic policies. Not only were there the policy disasters of the 1930s when De Valera embarked on a six-year "economic war" with Britain. This began in July 1932 with a refusal to continue to pay the land annuities agreed by an earlier government. In the 1950s there was an attempt to foster domestic industry behind tariff and regulatory barriers, an attempt which was doomed to failure by the small size of the internal market. From 1978 to 1982, macroeconomic policy was so bad that it sent growth into reverse between 1981 and 1986. Nevertheless, Ireland remains a laboratory experiment from which lessons can be drawn about some of the economic aspects of independence. Some of these lessons may be transferable to Scotland.

From the outset, Irish policy towards foreign direct investment (FDI) was to use fiscal incentives to enhance the profitability of locating in Ireland, with grants being used as required to achieve a particular bargaining advantage in competing against alternative international locations. In this policy, Ireland was for many years ahead of the rest of the field, but now governments throughout the world, and in particular in the EU, have adopted similar policies, so that the relative impact of Ireland's incentives have been eroded over the past decade. These developments mean that in future inward investment projects must be built on comparative national advantage, as well as lower wage costs and fiscal and financial incentives (Ruane and Gorg 1997). This is a lesson which Scotland must also learn.

For the past 25 years, the economies of both Scotland and Ireland have enjoyed inward fiscal transfers, much larger in the case of Scotland, from Whitehall and the EU respectively (see Table 4b). The result is to have launched a process of vigorous and, some would judge, self-sustaining growth in Ireland. When the injections from Europe come to an end, as they shortly will, the growth of the economy should continue, not necessarily at the rate of recent years, but perhaps at a more "normal" rate. In Scotland, there is neither evidence of high growth nor a sense that there is a self-sustaining growth process in train. On the contrary, the Ashcroft (1997) data updated in Chart 1 point to a continuing state of underperformance. The recent convergence of

GDP per capita with UK has been associated with continuing, for a time increasing, inward fiscal transfers.

Of course, one cannot simply copy policies and institutions and practices which, after a long drawn out historical process of trial and error, have apparently "worked" in Ireland. The circumstances of Scotland and Ireland, while similar in some respects are different in others, and some of the factors, like the demographic one, are simply not transferable. Other important differences include the operation of the labour markets in the two countries. However, one specific instrument of economic policy which it has been suggested an independent Scotland could immediately consider is the freedom to reduce the rate of corporation tax. Depending on the market reaction, this could benefit profitable investment from both inward (FDI) and indigenous sources alike. Any Laffer Curve effects, whereby the increase in profits realised in the corporate sector in Scotland are sufficiently increased to compensate for the reduction in the corporate tax rate, would depend on the elasticity or sensitivity of corporate investment to corporate tax rate. There is also the complication that Ireland may have realised a first-mover advantage here by establishing an early position as a low corporate tax regime within the EU. In any case, one instrument of policy is not by itself enough to make a difference, but a low rate of corporation tax would probably be high on any list of policies to be considered in an independent Scotland.

By bringing a government closer to those affected by its policies, independence offers the opportunity of sensible discussion of the alternative measures available to achieve them. Of course, it is not possible to know in advance which policies will work in actual circumstances. A traditional 'ca canny' approach may be the better alternative but one which could benefit from the experiences of others following the independence path. Therefore, one may learn from Ireland's policy mistakes as well as from its successes.

5. Questions of Transition.

Uncertainty and Business Confidence:

Business opinion in Scotland has a long tradition of hostility to any political change which seemed to weaken the Union with England. This is in contrast to other European regions such as Flanders or Catalonia, where business leaders have been in the forefront of devolutionary movements. Of course, this simply shows that the history and culture of each region is different. In Scotland, the received historical doctrine taught in all schools is the 19th Century Hume Brown version which argues that the Union was immensely beneficial to the Scottish economy, as it undoubtedly was for at least two hundred years, a period in which government played little part in economic activity.

Such well-established beliefs amongst Scottish businessmen were fortified in the twentieth century by two further developments. First, the growth in size of individual businesses and the reduction in transport costs meant that an increasing

proportion of businesses found that not only were they serving markets in England, but also that England accounted for the greater part of their sales. The access to the English market guaranteed by the Treaty of Union became more important than ever. It is therefore one of the small ironies of history that this particular provision of the Treaty of Union should have been rendered redundant by Mrs Thatcher when she signed the treaty in 1985 establishing the Single European Market.

The second development was the rise to political influence of the Labour Party. In Scotland, Labour-controlled local authorities have often been aggressively hostile to business, an attitude reflected in the imposition of high, sometimes penal, local taxes (rates) on property. Not surprisingly, this has been bitterly resented, particularly by small businesses. Since the introduction of a Uniform Business Rate (UBR) across the UK, relations between businesses and their local government authorities have improved, but the suspicion still lingers that a Labour-controlled government in an independent Scotland would re-introduce policies which could be inimical to business interests. This suspicion is strengthened by the mistaken belief that Scotland was and is an intrinsically "socialist" country. In the post-war period only one political party has ever gained an absolute majority of votes in a General Election in Scotland, and that party was not the Labour Party but the Conservative Party in 1955.

Notwithstanding these considerations, today many senior businessmen, even among those opposed to political independence, are today willing to admit that they could "live with" independence, once achieved. What they fear most, they say, is the uncertainty which would accompany the transition to independence. In their view, this could be extremely damaging. This damage would be worse if the transition period were prolonged. The associated uncertainty would discourage inward investment, and cause a flight of capital. The example given is that of Quebec where recurring referenda on independence are said to have produced these results.

Terms of access to markets, and the costs of an independent government are uppermost in their minds. So far as the first is concerned, they would require to be reassured about the membership of EU and EMU of an independent Scotland. On the question of costs, they would wish to know what additional costs would fall on their businesses through higher taxes, if any. They would wish to know the size of the likely fiscal deficit, if any, which an independent Scotland would inherit at the time of its inception and its financial implications, and any additional costs which an independent government would be likely to incur.

The EU and EMU :

Devolution and the possibility of independence in Scotland may be seen as a particular instance of a Europe-wide phenomenon, the passing of some political powers upwards from nation-states to a European level, and at the same time other powers being passed downwards to regional governments. Powers passing upwards include some of direct concern to business, namely regulatory powers over many areas of activity, notably competition, responsibility for international trade policy and its implementation, and, of course, monetary policy and tax harmonisation. While political power at the European level remains largely in the hands of member state

governments, those member states which have joined EMU have in theory no direct influence on monetary policy, according to the constitution governing the operations of the European Central Bank. By contrast, each individual member state has a veto over any legislation concerning taxation. It is clearly important for business interests in each country that they should be represented at the "top table" of European decision-making, namely the Council of Ministers, where each member state is represented.

Would Scottish business interests be better represented by a Scottish presence in the Council of Ministers, or would they would be better represented by the UK Government? This is really an empirical question, although unionists might point out that most decisions are taken by qualified majority voting, and that larger states have more votes than smaller ones. On the other hand, there has been no suggestion, for example, by Danish or Irish business that they are disadvantaged. Anecdotal evidence would appear to suggest that the reverse is true. Smaller countries are able to negotiate outcomes which mean a significant gain to them, but a small sacrifice to a larger country.

The more fundamental question is whether an independent Scotland would be better off as a member of the EU, like Denmark and Finland, or to remain outside the EU, like Norway. Norway is a member of the EEA, which means that while it enjoys most of the privileges of EU membership, it has to accept all the rules. In theory, it has no say in the formulation of these rules, although in practice, where vital national interests like gas trading are concerned, it does. Given that Scotland already enjoys membership of the EU with all that that implies about guaranteed access to a market which accounts for 60% of Scotland's exports, it might seem quixotic to step outside. It seems unlikely that any benefits gained in terms of protected access to depletable natural resources would be commensurate with the potential losses.

It is conceivable that an independent Scotland might have to formally request entry to the EU against its will. However, legal opinion appears to be agreed that citizens of Scotland would continue to enjoy their rights under EU Law, whatever changes there might be in the constitution of the UK. For Scots to be stripped of these rights would require a change to the Treaty of Rome[6] (Lane, 1991).

With 11 of the 15 member states having surrendered their monetary sovereignty to the European Central Bank (and the remaining four, Denmark, Greece, Sweden and the UK looking set to follow), attention has focused on tax policy as the remaining major instrument of economic policy at the disposal of member governments. It is suggested that even this instrument is becoming of limited significance because, on the one hand, of the mobility of tax bases and, on the other hand, the harmonisation of tax rates across the EU is the logical counterpart to removing trade barriers. So far, only VAT rates have been "harmonised", but some remarks of the then finance minister of Germany, Oskar Lafontaine, were interpreted to mean that Germany would also seek to have uniform rates of corporation tax established across the EU. While there is general agreement that discriminatory corporate tax rates should be ruled out, the majority of member states, including the UK, continues to resist any suggestion that they should be obliged to conform to any centrally prescribed general level of corporate taxation. Since such a proposal would

require unanimity, the Germans have recognised that there is little prospect of this happening.

Instead, what is likely to happen is that, since capital is highly mobile, a process of arbitrage will cause most rates within the EU to converge on a narrow band, with a mean lower than at present. The Irish have set the tone by announcing, with the agreement of the Commission, that they plan to lower their rate of corporation tax to 12 ½ % over the next five years.

Would an independent Scotland as a member of the EU wish to join EMU or remain outside? It is sometimes said (e.g., by Begg, 1999) that in to-day's global financial markets, a separate Scottish currency would simply be subjected to currency speculation. It is true that Finland, a prospective member of EMU, was less adversely affected than the other Nordic countries by the currency turmoil in 1998, despite its dependence on raw materials and relatively large exports to Russia. Norway does not feel under any pressure to surrender its independent currency. Nevertheless, it should be remembered that, whatever the choice of exchange rate or monetary policy regime may be, there will always be difficulties in stabilising a small open economy vulnerable to fluctuations in the international economy.

The argument so far could lead one to suppose that little is to be gained from exchanging one monetary regime which pursues policies which are not necessarily "appropriate" for the Scottish economy for another. Nevertheless, it could be claimed that the external exchange rate of the euro is unlikely to be as volatile as that of sterling, and that therefore Scottish exporters would be less vulnerable to monetary policy "errors". However, it is undeniable that the absence of any flexibility in the exchange rate over the greater part of Scottish trade means that the burden of adjustment required to correct adverse trade movements would be thrown onto labour markets and changes in taxation. It would be possible in principle to link a future Scottish currency with the currency of another trading partner, namely the dollar.

What would happen if England decided to remain outside EMU ? In that event, Scotland would find itself in a similar position to that in which Ireland finds itself at the present time, although, since joining the EU Ireland has significantly reduced its trade dependence on the UK. If the Irish example is relevant, it might be desirable for Scotland to delay its accession to EMU until its trade became sufficiently diversified.

The Public Sector and the move towards independence:

Although we have stressed that the future of the Scottish economy can only be influenced by government policies to a limited degree, independence can only be regarded as a serious alternative to other forms of government if a sound system of public finance can be put in place. Perceptions of 'sound finance' may differ, but there can be no doubt that they will have the common property that the growth in government spending must be kept under control and in a way which avoids major changes in the proportion of personal and corporate incomes paid in taxes. A clear agenda which indicates how this precept will be implemented would be called for, otherwise support for independence within Scotland could be undermined and the

confidence of the outside world in the ability of Scotland to run its own affairs could be eroded.

The first item on the agenda would be a forward projection of government income and expenditure in Scotland through the period of transition to independence and which shows clearly how the projection compares with the expected growth in the Scottish economy. To be of use, a projection of this sort must make its assumptions clear. Two examples illustrate the kind of difficulties about transitional financial arrangements which would be revealed by the projection. The first is that estimates of the taxable capacity of Scotland will depend on the ease or difficulty with which a national tax administration could be up and running, as well as on the trends in national income and expenditure. It could be that for many years to come, the government of Scotland might find that the most efficient and equitable way to raise taxes would be to employ the UK Inland Revenue and Customs and Excise as their tax raising agents. The second emphasises the fact that the fiscal inheritance of an independent Scotland may depend on negotiations concerning a whole range of issues, notably how much of the national debt should be funded by Scotland. It is here that the fiscal balance calculations come into their own, for the partition of debt could depend on the incidence of fiscal deficits in past years and how far Scotland benefited from debt-financed expenditures. As we have seen, arriving at agreed estimates of this sort may not be easy, and negotiations are not likely to be confined to debt questions alone. It is quite possible that issues of this kind would only be resolved by some form of international arbitration.

The first stage concentrates on the fiscal balance problem but takes no account of the changes in the composition of taxes and expenditure. Such changes must follow if, as is often argued, independence gives Scotland the opportunity to alter the composition of taxes and expenditure to be more in conformity with Scottish preferences. It is unlikely that major changes of this kind could be embodied in a Forward Look stretching, say, five years ahead, but preparation for such changes would be expected. This second stage would give rise to a whole range of speculations about the changes that would conform with a sensible economic policy, and here we confine our attention to the argument that independence could bring with it an easing of pressure on the budget which would make it possible either to reduce the proportion of national income paid in taxes or to increase expenditure with obvious benefits to taxpayers such as education and health or a combination of both.

The most favoured scenario supporting this position would be the one in which sources of revenue, other than those derived from income and corporation tax whose rates are influenced by tax competition from abroad, might increase, and some forms of expenditure reduced without objections from the public. On the income side, oil revenues are a case in point, and so too is a possible net contribution from the EU. Relying on substantial increases in oil revenues, as we have already observed, would be a doubtful proposition. Assuming Scotland were in the EU, one has to remember that even if something like the present funding arrangements were to remain in place, the entry of Eastern European countries will profoundly affect the allocation of the Eurobudget and, given their present standard of living, to the detriment of any case that Scotland might make for being a net beneficiary. A passing mention might be made of the prospect for using debt finance as a way of financing government capital

expenditure. There can be no objection to this, and there is no reason to suppose that Scotsbonds would not find a market, but loans mean additional expenditure in the form of interest payments and eventual repayment, and it would be hazardous to assume that the return on the capital expenditure financed by loans would be sufficient to produce substantial budget savings.

On the expenditure side of the account, attention has centred on defence expenditure. Broadly speaking, if an independent Scotland had to retain the same defence capability as projected for the UK, then expenditures per head would probably have to rise, because of the loss of economies of scale and accumulated expertise in defence contracting. This, of course, draws attention to a general problem affecting a range of services in small countries. If Scotland were outside NATO it might be accused of 'free riding' on other friendly countries committed to defence of the 'free world' and to the policing function associated with the attempts to prevent or stop civil wars. However, if Scotland were to remain in NATO, it might be acceptable to its allies if it joined without an independent nuclear capability. Others are better able to judge whether it is a feasible arrangement, but we can throw some light on the economic implications. Recent OECD estimates for 1995-96 show that UK defence spending was 3.4% of GDP (see Table 6g), a percentage which has been applied to Scotland. The percentage for Norway, a non-nuclear member of NATO was similar, but for Denmark, also a non-nuclear member, it was 1.7% and for Finland in 1997, not a member of NATO, it was 1.6%. If Scotland remained in NATO on the understanding that it is comparable to Denmark, then defence expenditure as a proportion of total government expenditure could be quite significantly reduced (OECD 1998).

The concentration on the use of a Forward Look approach as a way of examining the budgetary issues raised by a move towards independence has been determined by current debate in Scotland. However, it cannot reveal a complete scenario of change even if one recalls our previous observations of the restricted use that can be made of fiscal power to improve economic prospects. In recent years, the public sector in the wider sense, i.e., including public corporations, has been reduced in size through privatisation. This may have simplified the problem of partitioning government services in the UK in order to give effect to independence, because utilities that were previously nationalised are now in private hands. The only recent example of the voluntary dissolution of a political union in Europe offers some evidence to support the belief that unscrambling public sector assets need not pose a major problem. The Czecho-Slovak federation was dissolved on 31 December 1992. Within twelve months agreement had been reached on the division of 95% of the federal Government's assets (East and Pontin, 1997). However, there has been a substantial increase in the role of regulatory bodies designed to lower costs of entry into services previously monopolised by governments and to protect consumers. We can only draw attention to this development which would involve an independent government in detailed negotiation over the location and powers of regulatory regimes, bearing in mind also the regulatory system operated by the EU.

6. Conclusions.

The underlying analysis of this paper takes a dynamic view of the process of economic growth in which particular stress is placed on the expectations of those who produce goods and services, and therefore employment. Their decisions will be markedly influenced by the degree of confidence that can be placed in government decisions which affect their plans. Mathematical models do not help us very much here because relationships derived from econometric analysis and which hope to determine the link between decisions to spend, produce, lend and borrow cannot be assumed to be stable. Trying to second guess how governments will act is an inevitable part of business forecasting, but is bedevilled by the fact that governments themselves are likely to base their actions on expectations about the response of businesses and individuals to policy changes. Models are useful 'techniques of thinking' (Keynes's words) and essential for analysing policies, but the best contribution that policy advisers can make to helping businesses plan for future growth is to convince governments that they must do what is in their power to reduce the range of uncertainty affecting business decisions.

In principle, an independent government is in a much stronger position than a devolved government to fulfil this objective. This is because it has direct control over its budget, over the regulatory system, and over international economic relations. There is also an opportunity for more sensible public discussion of the impact of its policies when it has to raise its own revenue, the sources of which now become more transparent. However, important though these powers are, it has been necessary to emphasise that they will always be circumscribed by the influence of economic events outside Scotland. It may be possible to influence such decisions by inter-governmental negotiation as in the vital case of the terms and conditions of becoming separate from the rest of the UK and in determination of Scottish rights and responsibilities as a member of EU, EMU and NATO. An independent Scots government would still have to face the dilemma which all mature economies encounter in the recent marked increase in the mobility of capital and entrepreneurship which characterises the global economy.

An independent government cannot create profitable commercial opportunities, but it has to help business to realise these by business-friendly policies. How this may be done has been explained already in detail. It is only recently that this view could be described as a truism in the case of Scotland but it needs repeated emphasis because there is intense competition between governments in mature economies in devising such policies. Although confidence in Scotland's economic future may be tempered by the familiar worries about the weakness of its social infrastructure and communications, and its labour relations, these worries are by no means unique to it.

An independent government that paid due consideration to the economic issues that we have examined might reasonably be expected to be able to pursue economic policies that would give Scottish business and institutions and overseas companies located in Scotland the right incentives to maintain and improve economic progress. However, an independent government could not spring up overnight fully armed to undertake this task alongside the other objectives of policy which exercise a claim on fiscal resources. Particular attention would have to be given to economic measures

that would maintain the confidence of inward investors and the large financial sectors while the process of forming an independent state is in train. Not to do this could lead to a decline in support for independence itself.

Endnotes:

1. For economies like those of Scotland and Ireland, where a high proportion of economic activity is under external ownership, the normal measure of output, Gross Domestic product or GDP, is likely to overstate both the level and growth of incomes. A more appropriate measure is GNP, which takes account of incomes paid to and received from abroad, but no estimates of GNP are available for Scotland. An indicator of the possible size of the difference between the two measures is the fact that, for Ireland in 1995, the level of GNP was about 13.6% less than GDP (see Table 3), while the rate of increase of GNP in the five years ending 1995 was about ½ a percentage point per annum less than that of GDP (OECD 1997).

2. See the Financial Times of 27 January 1999.

3. For evidence, see Bradley and Hamilton (1999)

4. Hansard 21 March 1997 HMT Ref: 1657N 96/97.

5. The European Union currently comprises Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden and the UK. The European Economic Area also includes Iceland, Liechtenstein, Norway and Switzerland.

6. Furthermore, there is no provision in law or in practice for the remaining part of the UK, following Scottish independence, to appropriate UK membership, i.e. UK rights of representation.

BIBLIOGRAPHY

Ashcroft, B., (1997). *Scotland's Economic Problem: Too Few Entrepreneurs, Too Little Enterprise?* Strathclyde Papers in Economics 97/6. Glasgow : University of Strathclyde.

Baker, T.J., (1997). *The Roots of Irish Growth*, Mimeo. Dublin: The Economic and Social Research Institute.

Barrel, R. and Pain, N., (1997). "Foreign Direct Investment, Technological Change, and Economic Growth within Europe", *Economic Journal* vol. 107 No. 445.

Barry, F. and Bradley J., (1997). "FDI and Trade: The Irish Host-Country Experience" *Economic Journal* vol. 107 No. 445

Begg, David, (1999). "Scotland and EMU". Address to the Royal Society of Edinburgh, 29 January.

Bell, D., Dow, S., King, D., and Massie, N., (1996). Financing Devolution, *Hume Papers on Public Policy* vol. 4 No.2. Edinburgh: The David Hume Institute.

Bogdanor, V., (1998). *The Start of a New Song*, Hume Occasional Paper 55. Edinburgh : The David Hume Institute.

Bradley, J., FitzGerald, J., Honohan, P., and Kearney, I., (1997). "Interpreting The Recent Irish Growth Experience": *Medium Term Review 1997-2003* Dublin: The Economic and Social Research Institute.

Bradley J. (ed.), (1998). *Regional Economic and Policy Impacts of EMU: The Case of Northern Ireland.* Research Monograph No. 6 Belfast: Northern Ireland Economic Council.

Bradley, J., and Hamilton, D., (1999). *Accelerating Growth and Development: Border Effects in Ireland, North and South.* Dublin: The Economic and Social Research Institute.

Chennells, L., and Dilnot, A., (eds.), (1999). *The IFS Green Budget.* London: Institute of Fiscal Studies

The Constitution Unit, (1996). *Scotland's Parliament* London : University College.

Cuthbert, J., and Cuthbert, M., (1998a). The Implications of the Barnett Formula, *Saltire Paper No.* 1. Edinburgh: The Scottish National Party.

Cuthbert J., and Cuthbert, M., (1998b). "A Critique of GERS". *Quarterly Economic Commentary,* vol. 24, No. 1. Glasgow: The Fraser of Allander Institute.

East, R., and Pontin, J., (1997) *Revolution and Change in Central and Eastern Europe*. London : Pinter Publishers.

Fraser, M., Fry, M., and Smaill, P., (1998). *Full Fiscal Freedom*. Edinburgh: The Tuesday Club.

Hazell, R. (ed.), (1999). *Constitutional Futures*. Oxford: Oxford University Press.

Heald, D., (1994). "Territorial Public Expenditure in the United Kingdom", *Public Administration* 72, pp 147-175.

Kay, N., (1998). "The Scottish Parliament and the Barnett Formula", *Quarterly Economic Commentary* vol. 24 No. 1. Glasgow: The Fraser of Allander Institute.

Kemp, A.G., and Stephen L, (1999). Expenditures In and Revenues From the UKCS: Estimating the Hypothetical Scottish Shares 1970-2003 *North Sea Study Occasional Paper No. 70.* Department of Economics, University of Aberdeen.

Lane, R., (1991). Scotland in Europe: An Independent Scotland and the European Community, in Finnie, W. Himsworth, C. and Walker N, *Edinburgh Essays in Public Law* Edinburgh: Edinburgh University Press.

Lee, C.H., (1971). *Regional Economic Growth in the United Kingdom since the 1880's* Maidenhead: McGraw-Hill.

Lee, C.H., (1995). *Scotland and the United Kingdom: the Economy and the Union in the Twentieth Century.* Manchester : Manchester University Press.

McCrone, G., (1999). "Scotland's Public Finances from Goschen to Barnett", *Quarterly Economic Commentary*, vol.24 No.2, pp.30-46. Glasgow : The Fraser of Allender Institute.

McGregor, P.G., Swales, J.K., and Yin, Y.P., (1996). "Regional Public Sector and Current Account Deficits: Do They Matter?" in J. Bradley (ed.) *The Two Economies of Ireland.* Dublin: Oak Tree Press.

Midwinter, A., (1998). "Government Expenditure and Revenue in Scotland: Accounting for the Fiscal Deficit in 1996-97 "*Quarterly Economic Commentary*, vol. 24 No. 1, Glasgow: The Fraser of Allander Institute.

Noble, T.A.F., (1951). "The Economic Development of the Highlands, *The Manchester School*, May.

OECD, (1996). *Economic Surveys : The Slovak Republic*. Paris : OECD.

OECD, (1997). *Survey of the Irish Economy*. Paris: OECD.

OECD, (1998). *National Accounts*. Paris : OECD.

Payne, P.L., (1996). "The Economy" in T.M. Devine and R.J. Finlay (eds.) *Scotland in the Twentieth Century* Edinburgh: Edinburgh University Press.

Roper, S., Ashcroft, B., Love, J., Dunlop S., Hofman, H., and Vogler-Ludwig, K., (1996). *Product Innovation in UK, German and Irish Manufacturing*. Northern Ireland Economic Research Centre. Belfast: The Queen's University.

Ruane, F., and Gorg, H., (1997). "The Impact of Foreign Direct Investment on Sectoral Adjustment in the Irish Economy" *National Institute Economic Review* No. 160 .

Scott, A., and Cuthbert, M., (1986). Reviewing Industrial Aid Programmes (1) The Invergordon Smelter Case, *Hume Paper No. 2*, Edinburgh: The David Hume Institute.

The Scottish Office, (1998). *Government Expenditure and Revenue in Scotland 1996-1997*, Edinburgh : The Scottish Office.

Stevens, J., (1997). "The SNP Budget for Scotland – A Comment", *Quarterly Economic Commentary* vol. 22 No. 3. Glasgow: The Fraser of Allander Institute.

Statistical Appendix: **CONTENTS**

Tables:

Table 1 a) Total Gross Domestic Product at factor cost by Government Office Regions; 1994-1997

Table 1 b) Gross Domestic Product per head at factor cost by Government Office Regions; 1994-1997

Table 1 c) Gross Domestic Product per head as a percentage of UK GDP at factor cost by Government Office Regions; 1994-1997

Table 2 a) United Kingdom and comparator countries Unemployment Rate as percent of Labour Force (OECD definition); 1985, 1990, 1995-1998

Table 2 b) Scotland and United Kingdom Unemployment Rate as percent of Labour Force (ILO definition); 1985, 1990, 1995-1998

Table 3 GNP as a percentage of GDP for Scotland, UK and comparator countries; 1995

Table 4 a) Estimating the Scottish Deficit (ex Oil & Privatisation Receipts) as a Percentage of GDP; 1981-1994

Table 4 b) Irish Net Receipts from the EU (1974-1996) and the Scottish Deficit as a Percentage of GDP (1981-1996)

Table 4 c) Irish Receipts from the EU classified by type of funds; 1988-1996

Table 5 a) Percentage change in GDP at market prices for the UK and comparator countries (OECD figures and estimates); 1996-2000

Table 5 b) Percentage change in real GNP for Ireland (Average Annual Percentage Change); 1996-2005

Table 6 a) United Kingdom Regional Identifiable Government Expenditure as percent of UK Total; 1992-1997

Table 6 b) United Kingdom Regional Identifiable Government Expenditure per head as percent of UK Total; 1992-1997

Table 6 c) Scotland General Government Borrowing Requirement (GGBR), Government Expenditure (GGE) and Government Revenue (GGR) in current prices; 1992-1997

Table 6 d) Scotland Identifiable and Non-identifiable expenditure on services by sector; 1995

Table 6 e) Scotland Identifiable and Non-identifiable expenditure on services by sector as a percentage of GDP; 1995

Table 6 f) Scotland and UK total identifiable expenditure and service expenditure by sector as a percentage of GDP; 1995

Table 6 g) Comparator countries and UK total government outlays by sector and government consumption expenditure as a percentage of GDP; 1995

Table 7 a) Scotland's GDP per Capita and Population compared to EU member states; 1997

Table 7 b) Scotland's GDP per Capita in and Population compared to non-EU EEA countries and other European countries; 1997

Table 7 c) Scotland's GDP per Capita and Population compared to non-European OECD member states; 1997

Table 7 d) EEA member states and Scotland GDP per Capita and Population; 1997 (Ranked by GDP per Capita)

Table 7 e) EEA member states and Scotland GDP per Capita and Population; 1997 (Ranked by population size)

Table 7 f) Averages of GDP per Capita and Population of EEA countries contrasted with Scotland; 1997 (Ranked by GDP per Capita)

Table 8 a) Percentage change in GDP per head on a 5 year Average for Scotland, UK and comparator countries; 1973-1997

Table 8 b) Percentage change in Total Employment on a 5 year Average for Scotland, UK and comparator countries; 1967-1996

Table 8 c) Percentage change in Population on a 5 year Average for Scotland, UK and comparator countries; 1958-1997

Charts:

Chart 1 Scotland's GDP per head as a percentage of UK GDP per Capita; 1924-1997

Chart 2 a) Index GDP per head for Scotland, UK and comparator countries (1970=100); 1970-1997

Chart 2 b) Percentage change in GDP per head on a 5 year Average for Scotland, UK and comparator countries; 1973-1997

Chart 3 a) Index Total Employment for Scotland, UK and comparator countries (1966=100); 1966-1996

Chart 3 b) Percentage change in Total Employment on a 5 year Average for Scotland, UK and comparator countries; 1967-1996

Chart 4 UK, Scotland and other UK regions Unemployment Rates (Claimant definition[1]); 1954-1997

Chart 5 UK and Scotland Unemployment Rates (ILO definition); 1984-1998

Chart 6 a) Index Population for Scotland, UK and comparator countries (=100); 1955-1997

Chart 6 b) Percentage change in Population on a 5 year Average for Scotland, UK and comparator countries; 1958-1997

Chart 7 Firm Formation (VAT Registrations) per Thousand of Working Population; 1980-1988

Definitions

Sources and initial values of Charts

[1] Claimant Count Definition: See End of Statistical Appendix.

Table 1 a)

Total Gross Domestic Product at factor cost
by Government Office Regions[2] 1994-1997
(in £ million, current prices)

Region	1994	1995	1996	1997[3]
United Kingdom	**589484**	**618889**	**656184**	**694435**
United Kingdom[4] less Extra-Regio[5]	**578647**	**606878**	**641105**	**677914**
North East	*21524*	*22237*	*23163*	*24577*
North West (GOR) & Merseyside	*62243*	*64519*	*67596*	*72160*
Yorkshire and the Humber	*43750*	*46347*	*49334*	*51597*
East Midlands	*38451*	*40345*	*43479*	*45728*
West Midlands	*48573*	*51000*	*53659*	*56765*
Eastern	*52908*	*55509*	*58959*	*62619*
London	*90346*	*93849*	*98292*	*102638*
South East (GOR)	*89721*	*93848*	*101145*	*107833*
South West	*44515*	*47624*	*50539*	*54673*
England	**492030**	**515277**	**546166**	**578590**
Wales	**23703**	**25080**	**26253**	**27637**
Scotland	**49791**	**52614**	**54141**	**56219**
Northern Ireland	**13123**	**13907**	**14545**	**15468**

[2] Office of National Statistics: Regional Accounts.
[3] Provisional.
[4] Less statistical discrepancy in 1997 (£ 993 million).
[5] The GDP for Extra-Regio comprises compensation of employees, profits and stock appreciation which cannot be assigned to regions.

Table 1 b)

Gross Domestic Product per head at factor cost
by Government Office Regions[6] 1994-1997
(in £, current prices)

Region	1994	1995	1996	1997[7]
United Kingdom	**10095**	**10560**	**11159**	**11768**
United Kingdom less Extra-Regio[8]	**9909**	**10355**	**10903**	**11488**
North East	*8248*	*8536*	*8907*	*9473*
North West (GOR) & Merseyside	*9018*	*9351*	*9809*	*10481*
Yorkshire and the Humber	*8706*	*9215*	*9797*	*10244*
East Midlands	*9373*	*9783*	*10499*	*11002*
West Midlands	*9173*	*9611*	*10093*	*10669*
Eastern	*10130*	*10558*	*11140*	*11739*
London	*12967*	*13393*	*13894*	*14411*
South East (GOR)	*11526*	*11959*	*12811*	*13549*
South West	*9277*	*9866*	*10438*	*11213*
England	**10102**	**10537**	**11126**	**11740**
Wales	**8137**	**8598**	**8988**	**9442**
Scotland	**9701**	**10243**	**10558**	**10975**
Northern Ireland	**7993**	**8434**	**8745**	**9235**

[6] Office of National Statistics; Regional Accounts.

[7] Provisional.

[8] The GDP for Extra-Regio comprises compensation of employees, profits and stock appreciation which cannot be assigned to regions.

Table 1 c)

Gross Domestic Product per head as a percentage of UK GDP at factor cost
by Government Office Regions[9] 1994-1997
UK less Extra-Regio=100

Region	1994	1995	1996	1997[10]
United Kingdom less Extra-Regio[11]	**100.0**	**100.0**	**100.0**	**100.0**
North East	*83.2*	*82.4*	*81.7*	*82.5*
North West (GOR) & Merseyside	*91.0*	*90.3*	*90.0*	*91.2*
Yorkshire and the Humber	*87.9*	*89.0*	*89.9*	*89.2*
East Midlands	*94.6*	*94.5*	*96.3*	*95.8*
West Midlands	*92.6*	*92.8*	*92.6*	*92.9*
Eastern	*102.2*	*102.0*	*102.2*	*102.2*
London	*130.9*	*129.3*	*127.4*	*125.4*
South East (GOR)	*116.3*	*115.5*	*117.5*	*117.9*
South West	*93.6*	*95.3*	*95.7*	*97.6*
England	**101.9**	**101.8**	**102.0**	**102.2**
Wales	**82.1**	**83.0**	**82.4**	**82.2**
Scotland	**97.9**	**98.9**	**96.8**	**95.5**
Northern Ireland	**80.7**	**81.4**	**80.2**	**80.4**

[9] Office of National Statistics; Regional Accounts.
[10] Provisional.
[11] The GDP for Extra-Regio comprises compensation of employees, profits and stock appreciation which cannot be assigned to regions.

Table 2 a)

United Kingdom and comparator[12] countries Unemployment Rate
as percent of Labour Force (OECD definition[13])
1985, 1990, 1995-1998

	1985	1990	1995	1996	1997	**1998**
Denmark	7.3	8.3	7.0	6.9	5.4	**4.6**
Finland	5.0	3.4	17.0	16.1	11.9	**10.7**
Ireland	17.4	13.7	12.1	11.9	8.6	**7.2**
Norway	2.6	5.2	4.9	4.9	4.1	**3.2**
UK	11.5	5.5	8.6	8.2	7.1	**6.1**

Table 2 b)

Scotland and United Kingdom[14] Unemployment Rate
as percent of Labour Force (ILO definition[15])
1985, 1990, 1995-1998

	1985	1990	1995	1996	1997	**1998**
Scotland	13.7	9.3	8.3	8.7	8.5	**7.4**
UK	11.1	6.7	8.6	8.1	7.1	**6.1**

[12] OECD Main Economic Indicators; March 1999 and Labour Force Statistics 1976-1996.
[13] OECD definition: See definitions at the end of the statistical appendix.
[14] Office of National Statistics; Regional Accounts.
[15] ILO Definition: See definitions at the end of the statistical appendix.

Table 3

GNP (PPP, in US $)[16] as a percentage of GDP (PPP, in US $) for Scotland, UK and comparator countries (1995)

	GNP as a percentage of GDP	GDP per head in US $ (PPP)[17]	GNP per head in US $ (PPP)[18]
Denmark	97.41 %	22946	22352
Finland	96.59 %	18293	17669
Ireland	86.39 %	17854	15424
Norway	94.03 %	23209	21823
Scotland[19]	N/A	18032	N/A
United Kingdom	99.89 %	18233	18213

[16] Calculated from Historical Statistics OECD; 1997; Main Economic Indicators.
[17] Historical Statistics OECD; 1997; Main Economic Indicators.
[18] Derived from the previous values in the table.
[19] Scottish GDP figure based on the % of Scottish GDP in terms of GB GDP (98.9/100). Source: Scottish Statistical Office "Scottish Abstract of Statistics", 1998.

Table 4 a)

Estimating the Scottish Deficit (ex Oil & Privatisation Receipts)
as a Percentage of GDP
(in billions of £ and %)
1981-1994

	1981	1982	1983	1984	1985	1986	1987
Scottish Deficit (1996 Prices)[20]	3.29	5.12	5.37	5.21	4.77	4.68	5.85
Scottish GDP (current Prices)[21]	24.89	27.50	28.92	31.36	33.48	35.99	35.56
Price Index (1996=100)[22]	204	188	180	171	161	156	150
Scottish GDP (1996 Prices)	50.78	51.70	52.06	53.63	53.90	56.14	53.34
Scottish Deficit	6.48 %	9.90 %	10.32 %	9.71 %	8.85 %	8.34 %	10.97 %
	1988	1989	1990	1991	1992	1993	1994
Scottish Deficit (1996 Prices)	N/A	N/A	4.96	5.74	8.86	9.72	8.18
Scottish GDP (current Prices)	-	-	46.92	49.51	52.11	54.90	58.21
Price Index (1996=100)	-	-	121	114	110	109	106
Scottish GDP (1996 Prices)	-	-	56.77	56.44	57.32	59.84	61.70
UK	N/A	N/A	8.74 %	10.17 %	15.46 %	16.24 %	13.26 %

[20] Calculated from Public Finance Trends, 1996 and Hansard 1997, using total UK deficit and Scottish share of deficit as quoted in Wilson, Quarterly Economic Commentary, Vol. 22, No. 3.

[21] Calculated by using current GDP figures from the Annual Abstract of Statistics, Central Statistical Office, 1991 and 1998, and the Scottish share of UK GDP, Scottish Abstract of Statistics, CSO, various years.

[22] Calculated by using Internal Purchasing Power of the Pound (RPI based) from the Annual Abstract of Statistics, Central Statistical Office, 1991; p. 390.