Fiscal fantasy and fiscal federalism: first reflections on the Scottish referendum

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Outline of remarks

• Why did support for Scottish independence suddenly spike?
  – Good and bad reasons

• The bad reason: fiscal fantasy

• Two strategies to reduce fiscal fantasy
  – The marginal principle
  – Tiebout sorting

• Reconciling tax effort and egalitarianism – can it be done?
How should Scotland be governed (five response categories collapsed to three)

Notes and methodology for this question

Remove 'Don't Know' responses
Should Scotland be an independent country?

Notes and methodology for this question
The spike

• Support for independence stable at ≈30% since SSA started in 1999 (actually well before)
• For most of referendum campaign, 60/40 for No predicted
• Gap closed in last month: one poll Yes ahead, most had 52/48; actual result 55/45
Good reasons for voting Yes

• Get the govt we voted for
  – ‘no more Tory govts in Scotland’
• Get the UK nuclear deterrent out of Faslane
• Tiebout sorting – get the bundle Scots want
  – Greener
  – More open to immigration
  – More pro-EU
A warning about the good reasons

• Scots are more socially liberal, more social-democratic, and more pro-EU than rUK
  – At level of chattering classes (and recipients of Sc Govt grant) hugely so
  – At mass level, by ε
  – Shown by many surveys since 1970s
Position on libertarian-authoritarian scale (see notes for details)

Notes and methodology for this question
The bad reason: fiscal fantasy

• Spike steepened when FM Salmond said “vote Yes to save the NHS”, BUT:
  – NHS spend already wholly controlled in Scotland
  – Protected by 12%/head above UK mean transfer despite GDP/head ≈ UK mean (‘Barnett’)
• Generally, Sc Govt White Paper promised lots of spending increases (child care, pensions), and a tax cut (Corporation Tax – are you listening, Amazon?), but no tax increases and only one spending cut (defence)
• All parties did the same in 2007, 2011 elections
Illustrating the fiscal fantasy

• On Independence Day, before any policy changes, demographic change, interest rate change, or change in oil receipts:
• You swap oil receipts for Barnett and social-protection transfers
• Do you win or lose?
• And what about the near future?
Chart 4.4: Long-term projections of oil and gas receipts

Source: HMRC, ONS, OBR
Interpreting the known knowns

- All data from Scottish Govt (*GERS* – National Statistics) and OBR
- Scotland faces tighter fiscal squeeze than rUK
  - will have to raise taxes, cut spending or both
- Trading transfers for oil revenue is just a book transaction
  - Some years Scotland would have been better off with transfers, some years with oil
  - +£873/head in 08/09; -£478/head in 12/13
Interpreting the oil revenue predictions

• (More than) all the oil receipts would be needed to fund current spending
• An Oil Fund (good idea) would need to be financed by borrowing (bad idea) or by sharper fiscal squeeze than already predicted
• There should have been an oil fund in the 1980s, but there wasn't
• OBR numbers have been optimistic
So why did some people fall for fiscal fantasy?

• Sc Govt White Paper was not National Statistics and not reviewable by Statistics Authority

• Since 1999, devolved parlt's have spent but not taxed

• Not just SNP; all parties have engaged in “spend more, tax less” bidding war

• The only tax they do control – the best (land and property) - has been frozen
Two strategies

• The marginal principle:
  – At the margin, match $\Delta$ spending with $\Delta$ taxing

• The Tiebout principle
  – Let people vote with their feet
  – Pick the bundle of tax-and-spend that they like
The inexplicably ignored Scotland Act 2012

• Based on Canadian practice
• Adopts the marginal principle and enables the sc Parlt to be Tieboutian
• Vacate 10p in the £ of Income Tax; it is for sc Parlt to fix a rate
• Will bring honesty, and test whether people prefer policy variation or “no postcode lottery”
The ‘Vow’ of all the Unionist parties

- Made to a Scottish newspaper while in full-on panic mode
- On fiscal matters, adds nothing to 2012 Act – if marginal principle already in force, devolving more tax makes no difference
- Importance lies in constitutional matters
- Politicians make a basic mistake when they argue about whether Barnett will be protected
- It will be necessarily reduced in scope (that was part of the point)
- Already unravelling within hours of result
But are these changes compatible with egalitarianism?

• Need some redistribution to poor areas (though Scotland is not one)

• Can that be done while preserving local autonomy and local tax effort

• Yes – up to a point – it is done in Australia
Data sources and further reading

• **GERS** latest and [link to past years](#)
• OBR, [FSR](#)
• **Scottish Social Attitudes**
• I. McLean et al., *Scotland’s Choices 2/e 2014* (EUP/OUP)
• Calman Commission, [IEG, First Report](#)