
November 2013

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Ministerial Foreword

Scotland is a wealthy nation. Whether through the talents of our people or the natural resources of our country there is no doubt that Scotland has the potential to be a successful independent nation.

We have thriving sectors in energy, life sciences and the creative industries, we are a hub for the financial services sector, Scotland’s brand is recognised around the world benefitting both our tourism industry and our exports of food and drink, and our universities are amongst the best in the world. Our people are well educated and highly skilled.

On 18 September 2014 the people of Scotland will have the opportunity to choose the future for our nation and with that to choose the right economic path for Scotland.

As with any country we face economic challenges – the need to increase productivity, to improve the level of participation in our economy by securing new and long term job opportunities and to reduce inequality.

These challenges exist whether the Scottish people vote for independence or not, however at the centre of the debate on our future is a decision about how we best equip ourselves to meet the challenges, seize opportunities and secure the future for people living in Scotland now and in years to come.

The Scottish Government believes that the best option for Scotland is to become independent. It will create the opportunity to build an economy that takes advantage of Scotland’s unique strengths and size, and which delivers a more outward focussed, fairer and resilient economy.
It is only through independence that Scotland can maximise its potential and deliver the type of economy and society that reflects the values of the people of Scotland.

Independence would allow future Scottish governments to combine powers over business investment, employment creation, taxation and welfare to secure stronger levels of economic growth from which all the people of Scotland could benefit. It would ensure economic policy is designed for the needs and opportunities of the Scottish economy, provide greater flexibility in decision making and offer an opportunity to rebalance the economy.

In contrast remaining within the Westminster system would see Scotland’s potential hampered by the increasing gap between rich and poor, the increasing concentration of economic activity in London and the South-East of England, and growing imbalances in the structure of the UK economy.

Much of the debate so far has centred on the short-term. This misunderstands the central purpose of independence. Any consideration of Scotland’s future must consider the long term vision for the country and the transformational opportunity of independence.

This report sets out the economic levers that would be available under independence in key areas such as competitiveness, innovation, sustainability and international trade. There are no overnight solutions – rebalancing the economy, boosting economic performance and tackling the long-standing inequalities in society will take time – but crucially we can only begin this journey with the powers of independence.

That is the choice of two futures open to voters on the 18th September next year and one I am confident will see Scotland take the steps we need to transform our economy for the benefit of all of Scotland.

JOHN SWINNEY MSP
Cabinet Secretary for Finance, Employment and Sustainable Growth
Executive Summary

- A nation’s economic prosperity depends upon the strengths and talent of its people, its natural resources, its infrastructure and how it is governed.

- Scotland has the economic and financial strengths to be a successful independent nation.

- Even excluding the contribution of the North Sea, output per head in Scotland is 99% of the UK average and the highest outside London and the South East. Adding in a geographical share of North Sea output gives Scotland an output per head approximately 20% higher than the UK.

- Across a range of indicators – such as productivity and labour market outcomes – Scotland’s performance relative to the UK as a whole, and its countries and regions, is strong and has improved since devolution.

- While Scotland performs well as an economy within the UK, many other comparable independent countries perform better, not just economically, but also on measures of equality and well-being, pursuing economic models that are designed for their own needs and which deliver more sustainable and inclusive levels of growth.

- The UK economic model has not always served Scotland well. It is prone to instability and has increasingly large social and regional inequalities – with the UK now one of the most unequal societies in the OECD across a range of measures.

- The same economic model has also led to a substantial decline in the manufacturing sector, which now accounts for a much smaller part of both the UK and Scottish economies than key competitors. This explains, in part, why the UK has been in a current account deficit in 29 of the last 33 years.

- Scotland has a number of strengths, such as substantial natural resources, a skilled workforce, a reputation for innovation, an internationally-recognisable brand, substantial natural resources, and sectors and companies competing at the highest level in international markets.

- But it also faces a number of challenges, such as areas of peripherality and being tied to a UK economic model which is increasingly un-balanced.

- The role of economic and social policy, and the institutions that deliver them, are fundamental in determining economic performance and outcomes. They shape the
degree of income inequality and a country’s approach to sustainability and economic resilience.

- Successful economic policy requires choices, opportunities and a careful balance of trade-offs. The right approach will vary by country. It will differ because of the preferences and priorities of the people who live there and the unique challenges and opportunities that a country’s resources and economic and social history provide.

- Whilst under the current framework Scotland has devolved responsibilities for some areas which can influence long-term performance, ultimately the vast majority of the key decisions that influence Scotland’s economic structure, rate of growth and levels of income equality are made by the UK Government and for the UK as a whole.

- Such decisions are generally made on a ‘one-size-fits-all’ basis which the Scottish Government believes are heavily determined by the interests of London and the South East of England. They are not set for Scotland’s distinct circumstances. This puts Scotland at a significant disadvantage relative to comparable independent nations.

- Moreover, effective policy is constrained as the benefits of good policymaking, in areas such as social housing, the living wage and employability, in the form of higher tax revenues or lower welfare payments do not flow back to the Scottish budget to be recycled and invested in new programmes.

- Independence would enable future Scottish governments to create a genuinely bespoke set of complimentary policies - whether in relation to taxation, innovation, labour market regulation or industrial policy - under an overarching national framework more aligned with Scotland’s unique strengths and preferences.

- Boosting economic performance and tackling long-standing inequalities in society will take time. Independence would however, create the opportunity for Scotland to pursue a more productive, resilient and fairer economic model. A model focused on delivering long-term sustainability and economic opportunity for all and not a targeted few.

- Policy choices under independence could include -
  
  o Building a new vision for the type of economy and society that captures the values of the people of Scotland and creating distinct economic, industrial and social policies which reflects these aims;
• Creating a genuine partnership approach to developing, and taking forward, economic policy – involving the public, private and third sectors alongside employers and employees;

• Making responsible choices over welfare and employment policies to tackle long-standing inequalities – both social and regional – that have persisted for decades and re-invest the proceeds of success in creating a fairer and more inclusive society;

• Using tax powers, regulation and Scotland’s new global status to develop growth sectors and growth companies, widen the export base, attract investment, and support local firms to move into new and emerging markets;

• Developing an industrial strategy that promotes manufacturing and innovation and their links to the local supply chain;

• Prioritising targeted policy initiatives to constraints that hold Scotland back - for example, aviation duty and its links to international connectivity;

• Building a more resilient and stable macroeconomic framework;

• Designing a more efficient tax system;

• Coordinating devolved powers with new tax and expenditure responsibilities - for example, in skills, employability, and childcare – to deliver more joined-up policy responses;

• Providing the infrastructure required for rural areas to fully participate in economic life through improved communications technology, community enterprises and a focus on innovation in traditional industries such as food and drink, agriculture and fishing;

• Taking full responsibility for Scotland’s natural resources, both land and sea, to maximise opportunities from the low carbon economy; and,

• Aligning education and skills policy with industrial and employment policies to facilitate more – high value – employment opportunities and meeting an objective of full employment.

• This illustrates what choice could look like – and clearly there are a great many more policy opportunities with independence. Independence would enable future Scottish governments – whatever their political colour – to look at the way issues are tackled in a new light, with a broader range of options and opportunities to do things differently.
Chapter 1: Introduction

Chapter Summary

- Scotland is wealthy and productive. Performance relative to the UK as a whole, and its nations and regions, is strong.
- Scotland has the economic and financial strengths to be a successful independent nation.
- Many other comparable independent countries perform better however, not just economically, but also on measures of equality and well-being, pursuing models of development that have delivered more sustainable and inclusive levels of growth.
- The key powers to protect, grow and transform Scotland’s economy lie with the UK Government.
- The UK economic model has not always served Scotland well and has been prone to instability. It has embedded inequalities and concentrated economic activity in London and the South East.
- It is essential that Scotland takes a different path and does so as quickly as possible.
- Independence provides an opportunity to unlock Scotland’s full potential and, over the years and decades that follow, to create a fairer and more resilient economy.

Overview

1.1 Scotland has strong economic foundations.

1.2 The country has substantial natural resources, a highly-skilled workforce, a long-standing reputation for innovation, an internationally-recognisable brand, and products and companies competing at the highest level in international markets.

1.3 The Scottish economy is of a size large enough to develop companies and sectors of scale but also small enough to be flexible and responsive to change. Scotland is part of the world’s largest economic area with access to 500 million customers across the European Union.

1.4 On key economic indicators, Scotland is wealthy and productive and performance relative to the UK as a whole, and its nations and regions, is strong.
1.5 With access to the additional levers provided through devolution – and the, albeit limited, ability to tailor policies to local circumstances – successive Scottish administrations have helped to narrow an historic gap in performance with the UK.

**Key Fact:** Excluding North Sea Oil and Gas, Scotland’s output per head is 99% of the UK total and around 120% when North Sea output is included.

1.6 Many other comparable independent countries perform better however, not just economically, but also on measures of equality and well-being.

1.7 In common with the UK and most other advanced economies, Scotland will face a number of challenges in the years to come, such as demographic change, the need to rebalance the public finances, tackle inequalities, and to build greater economic resilience. Scotland is, however, also well placed to benefit from new opportunities such as a comparative advantage in the low carbon economy, the growth of new markets, the emergence of the digital economy and Scotland’s strengths in human capital.

1.8 The Scottish Government believes that Scotland’s ability to meet these challenges and to benefit fully from future opportunities is constrained by the fact that key economic powers – around 85% of tax revenues for instance – are controlled by the UK Government. This is not to say that UK policies are necessarily always wrong, but that they are not, and cannot be, set for Scotland’s distinct circumstances.

1.9 As part of the UK, Scotland is also currently tied to one of the most unequal economic models in the OECD. Poverty levels in Scotland, although somewhat lower than the UK, are too high and far too many people face poor economic prospects. UK labour markets may be some of the most flexible in the world, but job security and work conditions lag behind other more successful countries.

1.10 The UK economy is also prone to instability. Despite recent quarters of growth, the UK has had the weakest economic performance, with the exception of Italy, of any G7 nation during the financial crisis.\(^1\) Debt is amongst the highest in the OECD.

\(^1\) Up to Q2 2013.
1.11 Far from being protected by Westminster, the Scottish Government believes that Scotland’s economy has often been subject to its harshest effects. For example, much of Scotland’s traditional economic base was exposed to the sharp decline of industry in the 1980s and the resulting lack of investment in the communities and people affected.

1.12 Despite Scotland’s historic reputation for industry and innovation, manufacturing is now a much smaller part of both the UK and Scottish economies than key competitors. This explains, in part, why the UK has been in a current account deficit in 29 (trade deficit in 23) of the last 33 years.

**Key Fact:** Scotland’s average annual growth rate over the 30 year period to 2007 was 0.6 percentage points lower than comparable European countries.

1.13 There is now a growing recognition of the need to enhance the economic responsibilities of the Scottish Parliament.

1.14 The Scottish Government believes that independence will provide the opportunity to build a new economic framework that took advantage of Scotland’s unique strengths and size, and which would deliver a more outward focused, fairer and resilient economy. It would also provide the tools to address key challenges – such as social deprivation and poverty – which have a long legacy in certain parts of the country.

1.15 Instead of more of the same, independence would create the opportunity to take the Scottish economy on a different path, one that reflected the priorities and values of the people of Scotland and the strengths and comparative advantages of the Scottish economy.

1.16 There will be choices, and trade-offs to be considered in establishing new priorities for Scotland. The Scottish Government believes that ultimately, the best people to take such decisions and to prioritise choices are those most affected by them - the people of Scotland.

1.17 As an illustration, key overarching priorities to govern economic and social policy choices in an independent Scotland could be –

- Establishing a partnership approach to developing, and taking forward, economic policy;
- Maximising long-term economic value creation across the economy;
• Strengthening Scotland’s international competitiveness by taking a proactive role in the global arena (and exploiting opportunities from networks of trade, investment and innovation);

• A focus on creating more sustainable and higher quality employment opportunities;

• Building a reputation of competence and discipline in the application of economic policy and the management of Scotland’s public finances;

• An industrial strategy with a strong focus on diversification, the opportunities from manufacturing and strengthening Scotland’s small and medium-sized enterprises; and,

• Exploiting Scotland’s scale to deliver a more effective and joined-up government and economic policy making environment - including the establishment of a modern and efficient taxation system which promotes sustainable growth and a welfare system fully coordinated with all aspects of economic policy built upon a stronger principle of fairness.

1.18 The long-term outlook across the UK makes achieving full autonomy all the more vital. The regional concentration of economic activity in the UK is one of the most unbalanced in the world. Whilst Scotland has performed well in resisting the pull of London and the South East, this challenge and the focus of UK policy is only likely to make this even more difficult in the years to come.

**Key Fact:** The UK economy is one of the most unequal in the developed world. In 2010, the UK was ranked 28th (out of 34) OECD countries in terms of income equality.

1.19 At the same time, many of the values supported in Scotland, such as retaining public assets and fair and supportive welfare are now being challenged – a process that the Scottish Government believes is likely to intensify under the current arrangements. This will come directly through UK reserved policies impacting on Scotland – such as the ‘Bedroom Tax’\(^2\) – but also indirectly through threats to the way in which public services in Scotland are funded.

\(^2\) Households in the Social Rented Sector in receipt of Housing Benefit who are deemed to be ‘under-occupying’ their property will see a reduction in their Housing Benefit. This is known colloquially as the “bedroom tax”.  

4
The Opportunities from Economic and Fiscal Levers

1.20 To assist in the development of an economic framework for an independent Scotland, Scottish Ministers established the Fiscal Commission Working Group.

**Key Fact:** When an illustrative share of North Sea output is included, it is estimated that in 2011 Scotland would be 8th in terms of GDP per capita in the OECD.

1.21 In February 2013, the Working Group published their first report, which set out a practical and robust macroeconomic framework for Scotland.

1.22 The Working Group proposed that Scotland retain Sterling in a formal monetary union with the UK post-independence. As the UK’s second largest trading partner, the group concluded that this would be in the clear economic interests of both countries and they put forward a detailed proposal for how such a model could be successfully delivered.

**Key Fact:** Productivity, measured as output per hour worked, in Scotland was identical to that of the UK in 2011.

1.23 The Working Group noted that the framework provided a degree of integration to maintain and build upon existing trade, economic and financial links, but would also represent a “substantial step-change in the economic responsibilities of the Scottish Parliament and greatly increase the levers at the disposal of policymakers in Scotland.”

1.24 The report’s recommendations included that –

- *The Scottish Government should take forward a programme of work to identify and develop key economic and fiscal policy opportunities and choices within the proposed framework to deliver economic growth, resilience, fairness, opportunity and sustainability.*

- *As part of this work, lessons should be drawn from the successful use and application of economic levers from other economies of comparable size.*
• In particular, in addition to boosting economic growth, the Government should explore and prioritise opportunities to address inequalities and to promote inter-generational equity and environmental sustainability.”

1.25 This report is the Scottish Government’s response to these recommendations. It takes the Working Group’s macroeconomic framework – including retaining Sterling – as given and highlights the policy levers, challenges and opportunities that would follow.

1.26 Independence will provide the Government of Scotland with access to a suite of economic levers over which the UK Government has previously held control. The common theme throughout this paper is that access to such levers will enable future Scottish governments to create a genuinely bespoke set of complimentary policies under an overarching national framework more aligned with Scotland’s unique circumstances, strengths, and preferences.

1.27 Whether in relation to taxation, innovation, labour market regulation or industrial policy, Scotland is characterised by different economic structures, connections and interactions than the UK. It therefore follows that policy set at the UK level, with its tendency to be driven by conditions in the South East of England, will not and cannot be optimal for Scotland.

Report Structure and Overview

1.28 Chapter 2 provides a short summary of the Scottish economy.

1.29 Chapter 3 examines the current framework (including the 2012 Scotland Act) and contrasts this with the offer of independence. Chapter 4 assesses both frameworks according to their ability to boost long-term competitiveness and deliver greater stability and resilience.

1.30 Chapters 5 – 9 set out a range of economic opportunities open to future Scottish governments under independence:

• Chapter 5 - Boosting Competitiveness and Reindustrialising Scotland;

• Chapter 6 - An Economy Wide Focus on Increasing Innovation;
• Chapter 7 - A Labour Market that is Resilient, Adaptable and Inclusive;
• Chapter 8 – Ensuring that Growth is Shared and Sustainable; and
• Chapter 9 – Scotland’s Position in a Globally Integrated Economy.

1.31 Chapter 10 concludes.
Chapter 2: The Scottish Economy - Strengths, Challenges and Opportunities

Chapter Summary

- Scotland ranks on a par with many other countries on key economic measurements such as output per head and competitiveness.
- Since the re-establishment of the Scottish Parliament in 1999, the performance of the Scottish economy has improved but has yet to match the performance of many other similar countries.
- The Scottish economy has international advantages in diverse sectors including food and drink, energy, the creative industries, financial services, life sciences and tourism.
- Scotland also has a world class research base, with top-ranking universities, and a reputation for science and engineering.
- As a location for international investment, Scotland performs strongly, and is regularly near the top of investment league tables.
- Scotland also benefits from mature and well-functioning institutions. It has an open economy with a skilled labour force.
- But the Scottish economy also faces challenges, not least tackling a long-term growth gap and addressing persistent economic inequalities.
- Whilst the overall picture is relatively strong there are areas for improvement. These include boosting the stock of business, increasing investment, improving levels of innovation and internationalisation and creating greater employment opportunities.

Introduction

2.1 This chapter provides an overview of the Scottish economy. It summarises the output contained in Chapter 4 of the Fiscal Commission Working Group's First Report. The Group’s findings are summarised in Box 2.1.

2.2 Under the current constitutional framework, Scotland is effectively a regional economy of the UK. It is therefore important to consider how the Scottish economy performs within that context. However, Scotland is also a nation and performance can be compared with a number of countries of similar size to Scotland, but who have full economic powers. Both sets of benchmarking are made.
The Fiscal Commission Working Group found that on current evidence, “By international standards Scotland is a wealthy and productive country”. Overall the Working Group concluded that “There is no doubt that Scotland has the potential to be a successful independent nation.”

This is echoed by the UK Government, with the Prime Minister stating that “It would be wrong to suggest that Scotland could not be another such successful, independent country” and the Deputy Prime Minister concluding that “Those, who say Scotland could not be an independent state are wrong. Scotland could be an independent state.”

The Working Group also highlighted however, that “in certain areas, in particular in relation to the long-term drivers of growth and business development, Scotland has lagged behind many of its competitors and there is scope for improvement. This relative under-performance has persisted for decades.”

The group identified key challenges around

- boosting export performance;
- increasing innovation;
- delivering greater and more rewarding employment opportunities;
- expanding the business stock (particularly of medium sized enterprises); and,
- tackling long-standing social challenges and lack of economic opportunity.

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Table 2.1: Key Facts: Scotland and the UK

<table>
<thead>
<tr>
<th></th>
<th>Scotland</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population (million), 2011</td>
<td>5.3</td>
<td>63.3</td>
</tr>
<tr>
<td>GDP Per capita (£), 2011</td>
<td>23,641</td>
<td>24,499</td>
</tr>
<tr>
<td>Including geographical share of North Sea output</td>
<td>28,600</td>
<td>24,499</td>
</tr>
<tr>
<td>Average GDP Real Growth Rate (%), 1977-2007&lt;sup&gt;12&lt;/sup&gt;</td>
<td>2.4%</td>
<td>2.9%</td>
</tr>
<tr>
<td>Employment Rate (%), (July-September 2013)</td>
<td>72.8%</td>
<td>71.8%</td>
</tr>
<tr>
<td>Unemployment Rate (%), (July-September 2013)</td>
<td>7.2%</td>
<td>7.6%</td>
</tr>
<tr>
<td>Net Fiscal Balance (% of GDP), 2011-2012&lt;sup&gt;13&lt;/sup&gt;</td>
<td>-5.0%</td>
<td>-7.9%</td>
</tr>
</tbody>
</table>

Source: Scottish Government, Office for National Statistics (ONS), OECD

Scotland’s Economy

2.3 In 2012, Scottish onshore GDP was around £127 billion.<sup>14</sup> Including an illustrative geographical share of the North Sea, the Scottish economy is measured to be around 17% larger at £149 billion (9.5% of the UK economy).<sup>15</sup>

2.4 Like most developed economies there has been a shift in recent decades to services from manufacturing. Services are currently estimated to account for around 70% of output and 80% of employment.<sup>16</sup>

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<sup>12</sup> This comparison covers the long-term (30 year) average growth rate prior to the onset of the global financial crisis and recession – the impact of which on future growth performance remains uncertain. Over the period 2007-2012, the gap in average growth rates between Scotland and the UK has narrowed in light of the shallower recession in Scotland.

<sup>13</sup> Includes an illustrative geographical share of North Sea revenues

<sup>14</sup> Source: Scottish National Accounts Project (SNAP), Scottish Government, http://www.scotland.gov.uk/Topics/Statistics/Browse/Economy/SNAP


<sup>16</sup> Source: Business Register and Employment Survey (BRES), Office for National Statistics (ONS)
Economic Prosperity

2.5 GVA/GDP\(^{17}\) – or output – per head is a commonly used measure of living standards.\(^{18}\) On this, and many other economic indicators, Scotland's performance has improved since devolution – Box 2.2.

2.6 In the 1950s, GDP per head was estimated\(^{19}\) to be around 10% lower in Scotland compared to the UK.\(^{20}\)

2.7 In 1999, excluding the North Sea, Scotland was ranked 4th out of the 12 UK countries and regions for output per head (95% of the UK figure). In 2011, Scotland had

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\(^{17}\) Gross Value Added (GVA) is equivalent to Gross Domestic Product (GDP) at basic prices.


\(^{20}\) Key factors influencing performance since include, regional economic policy – e.g. establishment of Scottish enterprise agencies; oil and gas cluster; devolution and the focus on supply-side drivers of growth; and the emergence of new strengths such as food and drink & international investment.
risen to 3rd behind London and the South East with output per head 99% of the equivalent UK figure.\textsuperscript{21}

2.8 Adding an illustrative geographical share of North Sea output moves Scotland to be ranked 2nd, with output per head approximately 20% higher than the UK figure.

**Figure 2.2: Output per Head across UK Countries,\textsuperscript{22} 1999 to 2011 (excluding North Sea Output). UK =100**

![Output per Head across UK Countries diagram]

2.9 However, while Scotland performs strongly relative to other parts of the UK, the onshore Scottish economy is outperformed on a number of international comparisons.

2.10 In 2011 for example, UK GDP per head was approximately 25% lower than in the US. The UK was ranked 16th out of 34 OECD countries. Onshore Scotland would be ranked alongside the UK. When an illustrative share of the North Sea is added, it is estimated (Table 2.2) that Scotland would be ranked 8\textsuperscript{th}.\textsuperscript{23}

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\textsuperscript{21} Source: ONS, December 2012, GVA per head at current basic prices on workplace basis, UK figure excluding extra-regio, http://www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-265236

\textsuperscript{22} Figures exclude North Sea oil and gas output.

Table 2.2: Estimate of Scotland’s OECD GDP per head ranking in 2011

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
<th>2011 GDP per capita</th>
<th>Index (USA=100)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Luxembourg</td>
<td>$88,601</td>
<td>184.4</td>
</tr>
<tr>
<td>2</td>
<td>Norway</td>
<td>$61,047</td>
<td>127.1</td>
</tr>
<tr>
<td>3</td>
<td>Switzerland</td>
<td>$51,507</td>
<td>107.2</td>
</tr>
<tr>
<td>4</td>
<td>United States</td>
<td>$48,043</td>
<td>100</td>
</tr>
<tr>
<td>5</td>
<td>Netherlands</td>
<td>$42,781</td>
<td>89</td>
</tr>
<tr>
<td>6</td>
<td>Ireland</td>
<td>$42,329</td>
<td>88.1</td>
</tr>
<tr>
<td>7</td>
<td>Austria</td>
<td>$42,186</td>
<td>87.8</td>
</tr>
<tr>
<td>8</td>
<td>Scotland <em>(Onshore + geographic share of North Sea output)</em></td>
<td>$42,124</td>
<td>87.7</td>
</tr>
<tr>
<td>9</td>
<td>Australia</td>
<td>$42,060</td>
<td>87.5</td>
</tr>
<tr>
<td>10</td>
<td>Sweden</td>
<td>$41,485</td>
<td>86.3</td>
</tr>
<tr>
<td>16</td>
<td>United Kingdom</td>
<td>$35,607</td>
<td>74.1</td>
</tr>
</tbody>
</table>

2.11 The UK’s position has remained broadly the same throughout the last decade. It has not been ranked in the top 10 since OECD statistics have been available (in 1970).  

2.12 Box 2.2 assesses Scotland’s recent performance on key economic metrics.

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24 Note that when an estimate of Scotland’s GDP per capita is included the UK ranks 17th.  
Box 2.2: Scotland since Devolution

Since 1999, Scotland’s economic performance within the UK has strengthened across a range of indicators – see Table 2.3.

Table 2.3: Change in Performance Since Devolution (1999)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Value in 1999</th>
<th>Performance Relative to UK in 1999</th>
<th>Rank (12 UK countries / regions) in 1999</th>
<th>Most Recent Value</th>
<th>Most Recent Performance Relative to the UK</th>
<th>Current Rank on most recent data (12 UK countries / regions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. GVA per head(^{26})</td>
<td>£13,125</td>
<td>95.0%</td>
<td>4th</td>
<td>£20,571</td>
<td>98.6%</td>
<td>3(^{rd})</td>
</tr>
<tr>
<td>2. Productivity (output per hour worked)(^{27})</td>
<td>na</td>
<td>98.2%</td>
<td>4(^{th})</td>
<td>na</td>
<td>100%</td>
<td>3(^{rd})</td>
</tr>
<tr>
<td>3. Employment rate (16-64)(^{28})</td>
<td>69.7%</td>
<td>-2.4 p.p.</td>
<td>9(^{th})</td>
<td>72.8%</td>
<td>+1.0 p.p.</td>
<td>4(^{th})</td>
</tr>
<tr>
<td>4. Unemployment rate (16+)(^{28})</td>
<td>6.9%</td>
<td>+1.0 p.p.</td>
<td>8(^{th}) (lowest)</td>
<td>7.2%</td>
<td>-0.4 p.p.</td>
<td>5(^{th}) (lowest)</td>
</tr>
<tr>
<td>5. Inactivity Rate (16-64)(^{29})</td>
<td>25.1%</td>
<td>+1.8 p.p.</td>
<td>8(^{th}) (lowest)</td>
<td>21.4%</td>
<td>-0.8 p.p.</td>
<td>4(^{th}) (lowest)</td>
</tr>
<tr>
<td>6. GDHI(^{29})</td>
<td>£9,771</td>
<td>92.7%</td>
<td>5(^{th})</td>
<td>£15,654</td>
<td>97.6%</td>
<td>5(^{th})</td>
</tr>
<tr>
<td>7. Full-time Gross Median Weekly Pay(^{30})</td>
<td>£329.00</td>
<td>95.2%</td>
<td>5(^{th})</td>
<td>£497.60</td>
<td>98.4%</td>
<td>3(^{rd})</td>
</tr>
</tbody>
</table>

2.13 Gross Disposable Household Income (GDHI) is another useful measure of living standards. In contrast to GDP, it captures the resources available to households for spending & saving (after incomes are redistributed in the form of taxes and benefit receipts).

\(^{26}\) GVA per head at current basic prices on workplace basis, weighted 5-year moving average, http://www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-265236


2.14 Scotland is ranked 5th in terms of GDHI per head in the UK. Once again, Scotland’s relative position has improved rising from 92.7% (1999) to 97.6% (2011) of the UK figure.

Box 2.3: Estimates of Scottish Gross National Income (GNI)

GDP is the total amount of economic worth produced in a country. In contrast, Gross National Income (GNI) is the total (net) income received both from domestic and foreign economic activity. GDP can be thought of as the total amount of output generated in a country and GNI the total amount of income available to a country.

The Scottish National Accounts Project has recently published experimental statistics providing initial estimates of GNI for Scotland. They show that, for 2010 and including an illustrative geographical share of the North Sea, Scotland’s GNI is estimated to be approximately £137 billion. This is estimated to be 5% lower than the equivalent measure of GDP, and reflects outflows of income associated with international companies operating in the North Sea. However, this does not remove the differential in Scotland’s favour.

GNI per head in Scotland in 2010 is estimated to be approximately £26,000. In comparison, UK GNI per head is estimated to have been approximately £24,000.

2.15 In 2012, gross median full-time weekly earnings in Scotland were £497.60 this compares to £505.90 in the UK.

2.16 In the decade up to the financial crisis, earnings in Scotland caught up with earnings in the UK. Over the period 2009 to 2012, real hourly earnings in Scotland have fallen to a slightly lesser extent (-8.1% in Scotland compared to -8.5% in the UK).

2.17 Taken together, these changes have contributed to a narrowing of the historical gap in weekly earnings, with Scotland moving from 95.2% of the UK average in 1999, to 98.4% in 2012.

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31 Experimental statistics are defined in the Code of Practice for Official Statistics as new official statistics undergoing evaluation. They are published in order to involve users and stakeholders in their development and as a means to build in quality at an early stage.


33 Annual Survey of Hours and Earnings, ONS. Data available from www.nomisweb.co.uk

Economic Growth

2.18 The current shape and strengths of the Scottish economy reflects a number of diverse but often interrelated factors, such as comparative advantages, workforce skills, reputation, population trends, institutions and international developments. It also reflects decades of economic policy decisions primarily by UK Governments but more recently in devolved areas by Scottish Governments.

2.19 Estimates of growth of Scottish GDP are available from 1963. Over most of this period, growth has been slightly slower than in the UK and comparable European countries – Table 2.4.

2.20 While small, these differences are significant. As an illustration, if, starting in 1963, the Scottish economy had grown at the average growth rate of comparable European countries – an average rate of 3.4% per year instead of 2.6%, then by 2007 GDP would have been 42% higher.

Table 2.4: Average Annual Growth Rates

<table>
<thead>
<tr>
<th>Time Period</th>
<th>Annual Average GDP Growth Rate</th>
<th>Gap (Scotland minus UK/Comparable European)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Scotland</td>
<td>UK</td>
</tr>
<tr>
<td>1963-1970</td>
<td>3.7%</td>
<td>3.3%</td>
</tr>
<tr>
<td>1970-1980</td>
<td>1.6%</td>
<td>2.0%</td>
</tr>
<tr>
<td>1980-1990</td>
<td>2.3%</td>
<td>3.1%</td>
</tr>
<tr>
<td>1990-1999</td>
<td>2.9%</td>
<td>3.0%</td>
</tr>
<tr>
<td>1999-2007</td>
<td>2.9%</td>
<td>3.1%</td>
</tr>
<tr>
<td>1963-2007</td>
<td>2.6%</td>
<td>2.9%</td>
</tr>
<tr>
<td>30 year average (1977-2007)</td>
<td>2.4%</td>
<td>2.9%</td>
</tr>
</tbody>
</table>

Source: SNAP, ONS, and OECD. Note that numbers may not sum due to rounding.

35 Historical GDP estimates (1963-1997) are based on estimates which have been converted to be consistent with the current UK Blue Book. As such they should be treated as a guide to historical trends rather than a definitive estimate. For further discussion see: http://www.scotland.gov.uk/Topics/Statistics/Browse/Economy/ScotStat/Meetings/SESCG212

36 The comparable European countries are: Austria, Denmark, Finland, Iceland, Ireland, Luxembourg, Norway (mainland GDP only), Portugal and Sweden. The average growth rate in GDP for this group of countries is un-weighted as the intention is to demonstrate an average position accounting for variations in growth between countries.

37 The period up to 2007 is used so as to exclude the (possibly) temporary – and the as yet uncertain – impact of the global financial crisis on long-term growth rates. The impact of the global financial crisis across a number of countries, including Scotland, is discussed in Chapter 4.

38 In line with convention, Scotland’s GDP series excludes output from North Sea Oil and Gas, whilst Extra Regio output is included in the headline UK series.
2.21 As the Fiscal Commission Working Group noted, finding reasons for Scotland’s long-term growth performance can be challenging, particularly given the lack of a clear counterfactual.

2.22 However, comparisons of historical growth rates are still useful in assessing performance within the current constitutional settlement. In this regard, it is widely accepted that Scotland has underperformed.

2.23 Like many countries, a key on-going challenge has been ensuring that what growth does take place is shared across the country.

2.24 Scotland faces two key challenges. Firstly, in rural Scotland there are unique barriers, such as remoteness and access to markets, which are on a scale different to other parts of the UK. Here, core economic infrastructure such as transport links and communications (e.g. digital, and postal services) and the importance of key sectors (e.g. fishing, agriculture and tourism) are vital to performance and regional prosperity.

2.25 Secondly, a number of areas of Scotland continue to live with the impact of the harsh economic consequences of industrial decline during the 1980s.

**Components of Aggregate Demand**

2.26 Before studying the supply-side of the economy, it is helpful to examine the components of demand. This can provide a useful indicator of the ‘type’ of economy a country operates.

2.27 Policy to influence demand is almost fully reserved to the UK. Supply-side policies are shared between the Scottish and UK Governments, although the UK Government’s role arguably still dominates.

2.28 The pattern of expenditure in an economy reflects a balance between household consumption\(^{40}\), government spending, investment and net trade (exports minus imports).

---

\(^{39}\) Data series from OECD: OECD annual GDP volume estimates, in millions of US dollars with fixed PPP (OECD reference year=2005)

\(^{40}\) Defined as the sum of household expenditures and expenditure by non-profit institutions serving households.
2.29 Like most countries, household consumption accounts for the largest proportion of expenditure in Scotland and the UK. Experimental Scottish National Accounts Project (SNAP) estimates that, in 2012, household consumption accounted for approximately 64% of aggregate demand\textsuperscript{41} in Scotland (slightly lower than the equivalent UK figure of 66%).\textsuperscript{42}

**Figure 2.3: Composition of GDP (Expenditure), 2012**

Source: Scottish Government Analysis, OECD

2.30 Household consumption accounts for a relatively larger share of the UK economy compared to other EU and G7 economies (with the exception of the US) – Figure 2.3.

2.31 The contribution of net trade is negative for the UK (i.e. reduces aggregate demand) and gross capital formation (of which business investment is the largest component) is lower than in other countries. Such trends are not new. Household consumption accounted for a significant proportion of the growth in the UK economy in the decade prior to the financial crisis – Figure 2.4.

2.32 A current account deficit is a net outflow paid for either by borrowing, selling assets, or returns and profits flowing overseas. Figure 2.5 highlights performance across a selection of OECD countries. Structural current account deficits can stifle growth and make an

\textsuperscript{41} SNAP: GDP by component of expenditure Scotland, current prices, Households final consumption.

economy vulnerable to shocks. Increased export activity has the potential to increase both levels of stability and GDP.

Figure 2.4: Contribution of Household Consumption to Growth in GDP, 1997 - 2007

2.33 The trade deficit is a narrower measure and focuses just on the trade of goods and services - or a country’s external trade balance with the rest of the world. The UK has run a trade deficit in nearly every year since the mid-1980s, and last ran a trade surplus in 1997.

---

2.34 Investment is a driver of growth over the medium term, not just its scale but also its quality is important (i.e. the ability to support innovation, embody new technology and build human capital). IMF data shows that the UK performs relatively poorly in comparison with other countries and, based on estimates for 2012, was ranked 30 out of 35 advanced economies for investment as a percentage of GDP.

Table 2.5: G7 Investment (Gross Fixed Capital Formation) as Percentage of GDP\textsuperscript{45,46}

<table>
<thead>
<tr>
<th>Country</th>
<th>Total Investment as % of GDP</th>
<th>2012 Ranking (out of 35 Advanced Economies)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canada</td>
<td>24.7</td>
<td>8</td>
</tr>
<tr>
<td>Japan</td>
<td>20.6</td>
<td>16</td>
</tr>
<tr>
<td>France</td>
<td>19.8</td>
<td>17</td>
</tr>
<tr>
<td>Italy</td>
<td>17.6</td>
<td>24</td>
</tr>
<tr>
<td>United States</td>
<td>19.0</td>
<td>22</td>
</tr>
<tr>
<td>Germany</td>
<td>17.3</td>
<td>27</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>14.7</td>
<td>30</td>
</tr>
</tbody>
</table>

Source: IMF (October 2013) World Economic Outlook Database

\textsuperscript{44} The transactions included comprise: goods, services, and income; those involving financial claims on and liabilities to the rest of the world; and transfers.


\textsuperscript{46} On the full dataset, the UK ranks 156\textsuperscript{th} out of the 172 countries for which the IMF holds data.
2.35 The UK’s performance reflects a number of factors, including low levels of government investment, tax and regulatory policies, a reliance upon low-investment sectors, and a culture that encourages short-term profit before long-term investment.

2.36 The Scottish Government believes that the UK’s reliance upon consumption – fuelled in part by borrowing and unsustainable asset price bubbles – the negative contribution of trade and low levels of investment are key reasons why growth and prosperity has lagged other countries. Under the current framework, Scotland is part of this model.

Drivers of Growth

2.37 Over the long term, growth depends on how well a country is able to develop key supply-side drivers – productivity, participation and population growth. For an economy to grow, the volume of inputs (traditionally classified as labour, capital and natural resources) has to rise and/or the productivity with which these resources are deployed must improve.

Productivity

2.38 As highlighted by the Fiscal Commission Working Group, productivity is the principle long-term driver of growth. More productive economies typically enjoy higher living standards. The effects of improvements in productivity on an economy can be significant – Box 2.4.

<table>
<thead>
<tr>
<th>Box 2.4: Impact of Boosting Scotland’s Productivity Performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Productivity is the dominant determinant of economic growth. It encapsulates how effectively goods and services can be produced from a given set of resources. More productive economies produce greater output for a given set of resources.</td>
</tr>
<tr>
<td>Productivity is driven by a number of factors, including innovation, education &amp; skills, capital &amp; infrastructure investment and competition.</td>
</tr>
<tr>
<td>Analysis demonstrates that even relatively small changes in productivity levels can have significant impacts.</td>
</tr>
</tbody>
</table>
Scottish Government analysis estimates that boosting labour productivity in Scotland by just 1% could increase output by approximately 1.7% (£2.1 billion) and raise employment by over 21,000 over the long-term (around 20 years). The competitiveness effects and boosts to the tax base could increase revenues by around 1.5% which can be recycled back into the economy through increased government spending.

**Figure 2.6: Long Term Impact of a 1% Increase in Productivity**

<table>
<thead>
<tr>
<th>Productivity</th>
<th>Output</th>
<th>Employment</th>
<th>Tax Revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.0%</td>
<td>+ £2.1 bn</td>
<td>+ 21,000</td>
<td>+ £0.7 bn</td>
</tr>
</tbody>
</table>

Source: Scottish Government analysis

Such figures demonstrate the benefits of greater economic success in Scotland. As highlighted in Figure 2.7, Scottish productivity currently lags many key comparators. For example, the gap between Scotland and the lowest ranked country in the top quartile of OECD countries (currently Germany) in 2011 was around 15.5%. Narrowing such a gap, as highlighted by the modelling of a 1% improvement, could have dramatic effects.

2.39 In 2011, Scotland matched the UK average in terms of output per hour worked and 99% of the UK average in terms of output per filled job. The gap in productivity between Scotland and the UK has been virtually eliminated narrowed in recent years – Table 2.3.

2.40 However, when comparisons are widened to international competitors, Scotland’s (and the UK’s) performance is less favourable.
2.41 In 2011, the UK was ranked at the lower end of the second quartile in the OECD in terms of productivity (measured as GDP per hour worked) – Figure 2.7.

Figure 2.7: Productivity Across OECD Countries,\textsuperscript{47} 2011

<table>
<thead>
<tr>
<th>Country</th>
<th>Top Quartile</th>
<th>Second Quartile</th>
<th>Third Quartile</th>
<th>Bottom Quartile</th>
</tr>
</thead>
<tbody>
<tr>
<td>Norway</td>
<td>120</td>
<td>110</td>
<td>100</td>
<td>90</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>110</td>
<td>100</td>
<td>90</td>
<td>80</td>
</tr>
<tr>
<td>Ireland</td>
<td>100</td>
<td>90</td>
<td>80</td>
<td>70</td>
</tr>
<tr>
<td>United States</td>
<td>90</td>
<td>80</td>
<td>70</td>
<td>60</td>
</tr>
<tr>
<td>Netherlands</td>
<td>80</td>
<td>70</td>
<td>60</td>
<td>50</td>
</tr>
<tr>
<td>Belgium</td>
<td>70</td>
<td>60</td>
<td>50</td>
<td>40</td>
</tr>
<tr>
<td>France</td>
<td>60</td>
<td>50</td>
<td>40</td>
<td>30</td>
</tr>
<tr>
<td>Germany</td>
<td>50</td>
<td>40</td>
<td>30</td>
<td>20</td>
</tr>
<tr>
<td>Switzerland</td>
<td>40</td>
<td>30</td>
<td>20</td>
<td>10</td>
</tr>
<tr>
<td>Denmark</td>
<td>30</td>
<td>20</td>
<td>10</td>
<td>0</td>
</tr>
<tr>
<td>Sweden</td>
<td>20</td>
<td>10</td>
<td>0</td>
<td>-10</td>
</tr>
<tr>
<td>Australia</td>
<td>10</td>
<td>0</td>
<td>-10</td>
<td>-20</td>
</tr>
<tr>
<td>Finland</td>
<td>0</td>
<td>-10</td>
<td>-20</td>
<td>-30</td>
</tr>
<tr>
<td>Spain</td>
<td>-10</td>
<td>-20</td>
<td>-30</td>
<td>-40</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>-20</td>
<td>-30</td>
<td>-40</td>
<td>-50</td>
</tr>
<tr>
<td>Scotland</td>
<td>-30</td>
<td>-40</td>
<td>-50</td>
<td>-60</td>
</tr>
<tr>
<td>Canada</td>
<td>-40</td>
<td>-50</td>
<td>-60</td>
<td>-70</td>
</tr>
<tr>
<td>Italy</td>
<td>-50</td>
<td>-60</td>
<td>-70</td>
<td>-80</td>
</tr>
<tr>
<td>Japan</td>
<td>-60</td>
<td>-70</td>
<td>-80</td>
<td>-90</td>
</tr>
<tr>
<td>Iceland</td>
<td>-70</td>
<td>-80</td>
<td>-90</td>
<td>-100</td>
</tr>
<tr>
<td>Slovenia</td>
<td>-80</td>
<td>-90</td>
<td>-100</td>
<td>-110</td>
</tr>
<tr>
<td>New Zealand</td>
<td>-90</td>
<td>-100</td>
<td>-110</td>
<td>-120</td>
</tr>
<tr>
<td>Slovak Republic</td>
<td>-100</td>
<td>-110</td>
<td>-120</td>
<td>-130</td>
</tr>
<tr>
<td>Greece</td>
<td>-110</td>
<td>-120</td>
<td>-130</td>
<td>-140</td>
</tr>
<tr>
<td>Portugal</td>
<td>-120</td>
<td>-130</td>
<td>-140</td>
<td>-150</td>
</tr>
<tr>
<td>France</td>
<td>-130</td>
<td>-140</td>
<td>-150</td>
<td>-160</td>
</tr>
<tr>
<td>Hungary</td>
<td>-140</td>
<td>-150</td>
<td>-160</td>
<td>-170</td>
</tr>
<tr>
<td>Poland</td>
<td>-150</td>
<td>-160</td>
<td>-170</td>
<td>-180</td>
</tr>
<tr>
<td>Mexico</td>
<td>-160</td>
<td>-170</td>
<td>-180</td>
<td>-190</td>
</tr>
</tbody>
</table>

Source: OECD, SG Calculations

Participation

2.42 Greater participation increases the economy’s potential output. It is also a key avenue through which important social objectives, such as tackling poverty, can be addressed.

2.43 When the current labour market series began back in 1992, Scotland had a lower employment rate than the UK. Since then, Scotland’s relative performance has strengthened.

\textsuperscript{47} Estimate for Scotland based on applying the figure on Scottish output per hour worked, produced by the ONS (100% in 2011), to the UK GDP per hour worked estimate provided by the OECD.
Table 2.6: Headline indicators by Country – July-September 2013

<table>
<thead>
<tr>
<th>Country</th>
<th>Employment Rate (16-64) Rate (%)</th>
<th>Unemployment Rate (16+) Rate (%)</th>
<th>Economic Inactivity Rate (16-64) Rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scotland</td>
<td>72.8%</td>
<td>7.2%</td>
<td>21.4%</td>
</tr>
<tr>
<td>England</td>
<td>71.9%</td>
<td>7.6%</td>
<td>22.0%</td>
</tr>
<tr>
<td>Wales</td>
<td>70.2%</td>
<td>7.8%</td>
<td>23.7%</td>
</tr>
<tr>
<td>N. Ireland</td>
<td>67.2%</td>
<td>7.3%</td>
<td>27.4%</td>
</tr>
<tr>
<td>UK</td>
<td>71.8%</td>
<td>7.6%</td>
<td>22.2%</td>
</tr>
</tbody>
</table>

Source: Labour Force Survey. July-September 2013, ONS

2.44 A key challenge will be tackling the rise in unemployment as a result of the recession. The experience of previous UK recessions has shown the importance of preventing potential loss of skills, increased inequality and social exclusion brought about by even temporary periods of unemployment.

2.45 A number of countries perform better in terms of unemployment (and also employment) than Scotland and the UK – Figure 2.8.

Figure 2.8: Unemployment Rates Across OECD Countries, 2012

Source: OECD (15yrs+) and ONS
2.46 Over the past decade or so, the majority of the growth in employment in Scotland was in the private sector.\textsuperscript{48} Around 22\% (21.8\% in Q2 2013) of employment in Scotland is in the public sector. This is slightly higher than for the UK as a whole.\textsuperscript{49} As a result of fiscal consolidation, public sector employment is now at its lowest share of total employment since devolution.

2.47 In terms of labour market participation—i.e. those in work or actively seeking work—Scotland is currently just outside the top-10 of OECD countries. A gap exists however, with the best performing countries, particularly in areas such as female participation—Table 2.7.

2.48 Tackling such issues is important. Scottish Government analysis shows that if the current economic activity rate in Scotland was to increase by just 1 percentage point, this could boost the level of output by around 0.6\% (£700 million) in the long-run. Such expansion would be associated with a greater intake of tax revenues, which would be expected to rise by 0.5\% in real terms (£230 million).

Table 2.7: Participation Rate by Gender (average over period 2004-2012)

<table>
<thead>
<tr>
<th></th>
<th>Total 15-64</th>
<th>Scotland Average Rank</th>
<th>Scotland Average Rate</th>
<th>Top Performer</th>
<th>Gap between Scotland and top performer</th>
<th>2nd Highest Performer</th>
<th>3rd Highest Performer</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>-9.8% points</td>
<td>Switzerland</td>
<td>Denmark</td>
</tr>
<tr>
<td>Male 15-64</td>
<td>10</td>
<td>75.8%</td>
<td>Iceland</td>
<td>85.6%</td>
<td>-7.6% points</td>
<td>Switzerland</td>
<td>Japan</td>
</tr>
<tr>
<td>Female 15-64</td>
<td>10</td>
<td>70.5%</td>
<td>Iceland</td>
<td>82.1%</td>
<td>-11.6 % points</td>
<td>Sweden</td>
<td>Denmark</td>
</tr>
</tbody>
</table>

Source: Scottish Government analysis of annual labour market data. Based on data from the Annual Population Survey, ONS and OECD.

2.49 Scotland currently has a higher youth employment rate than the UK and a lower youth unemployment rate.\textsuperscript{50}

---

\textsuperscript{48} Over the period 1999 Q2 to 2013 Q2 employment in the public sector (excluding public sector financial institutions) increased by 3,700 (0.7\%), whilst private sector employment increased by 272,000 (16\%) over the same period Source: http://www.scotland.gov.uk/Topics/Statistics/Browse/Labour-Market/PublicSectorEmployment.

\textsuperscript{49} The equivalent figure for the UK is 18.4\% – Q2 2013, ONS. http://www.ons.gov.uk/ons/rel/pse/public-sector-employment/q2-2013/stb-pse-2013q2.html.

\textsuperscript{50} The youth unemployment rate, based on non-seasonally adjusted data for Jul-Sep 2013, was 20.9\% in Scotland and 21.9\% in the UK. Source: LFS, Jul-Sep 2013, ONS. The youth employment rates in Scotland for Jul-Sep 2013 was 53.2\% compared to 49.7\% in the UK.
Population

2.50 The most significant determinant of Scotland’s long-term growth gap relative to the UK has been slower population growth.

2.51 Between 1977 and 2007, whilst growth in Scottish GDP was 0.4 percentage points lower than the UK, the equivalent GDP per capita growth rate gap was 0.1 percentage points.\textsuperscript{51} Had the Scottish economy grown at the same rate as the UK average over this period, GDP per capita would have been 3% higher in 2007, equivalent to an additional £720 per capita in 2007 (based on 2011 prices).

Figure 2.9: Growth in GDP and GDP per Capita, 1977 to 2007

2.52 Similarly, if Scotland moved from the rates of GDP per capita growth it has experienced in the past to instead match the average levels of growth of small European countries, the benefits for people in Scotland in terms of prosperity and employment could be significant. As an illustration, had growth in GDP per capita in Scotland matched that of other small independent nations between 1977 and 2007, GDP per capita would now be 3.8% higher, equivalent to an additional £900 per person.

\textsuperscript{51}Over the period 1977 to 2007, Scotland average annual growth rates for GDP and GDP per capita were 2.4% and 2.5%, respectively. The equivalent figures for the UK were 2.9% and 2.6%, respectively.
Box 2.5: Comparisons on GDP per Capita Growth Rates

This analysis has considered Scotland’s performance in terms of GDP per capita growth, relative to both the UK and a group of comparable small European countries: Austria, Denmark, Finland, Iceland, Ireland, Luxembourg, Norway (mainland GDP only), Portugal and Sweden.\textsuperscript{52}

The average growth rate in GDP per capita for this group of countries is un-weighted. The intention is to demonstrate an average position which reflects the fact that there are variations in growth between small countries.

The analysis highlights that when taken over a number of years, even small differences in growth trends can have a significant effect on total GDP per capita.

Between 1977 and 2007\textsuperscript{53}, Scotland’s onshore GDP per capita grew at an annual rate of 2.48\% in real (volume) terms. The rate for the UK over the same period was 2.58\%, and the average rate among small European countries was very slightly higher at 2.61\%. Over the thirty year period this means that UK GDP per capita increased by a total of 3.0\% more than Scottish GDP per capita. If the average growth rate for the small European countries is compared to Scotland, the extra growth in GDP per capita over a thirty year period adds up to 3.8\%.

It is estimated that if Scotland’s GDP per capita growth rate could be increased by as little as 0.1 percentage points annually, after ten years this would add an extra 1\% above trend to GDP per capita, an extra £237 per person in 2011 prices.

2.53 The demographic structure of a country has a range of implications, including for the public finances.

\textsuperscript{52} GDP per capita figures for European countries are sourced from the OECD statistics database and are expressed in millions of US dollars with fixed Purchasing Power Parity, in volume terms. GDP statistics for mainland Norway are converted from the national currency to a US dollar fixed PPP basis using the conversion factor derived from the OECD database.

\textsuperscript{53} See footnote 37.
2.54 Historically Scotland has had weak population growth. In fact, over the period 1974 to 2002 Scotland’s population had gradually declined. More recently that decline has been reversed.

2.55 Following devolution and the re-establishment of the Scottish Parliament in 1999, successive administrations have made boosting Scotland’s population a priority. The most recent Census showed that as at March 2011, Scotland’s population stood at 5.295 million – the highest ever. However, over the long-term this still means that Scotland’s population has grown more slowly than many other advanced economies.

2.56 Achieving population growth – particularly among those of working age – is arguably one of the most significant tasks facing advanced economies, particularly in the light of ageing populations.

Figure 2.10: Projected Population, 2010 to 2035, 2010 = 100

---

56 Note: The Eurostat projections of population in selected European countries are not directly comparable to the ONS projections of population within the countries of the UK. The Eurostat projections are based on estimates of the population at 1 January while ONS figures refer to 30 June. Methodologies in determining underlying fertility, mortality and migration assumptions also differ.
2.57 Between 2010 and 2035, the Scottish population is projected to increase by 10.2 per cent,\textsuperscript{57} this is above the EU average\textsuperscript{58} and significantly faster than countries such as Germany—Figure 2.10. Within this, the working age population is also projected to increase, although at a slower rate than the UK.\textsuperscript{59}

2.58 A key determinant of long-term economic potential is the balance of the working age population vis-à-vis the population as a whole.

2.59 The dependency ratio\textsuperscript{60} is the working age population relative to the pension age/child (under 16) population. It is forecast to rise in Scotland. This increase is due to a relative increase in the number of older people in the population.

2.60 Based on current projections, Scotland is projected to have a lower dependency ratio than the UK until approximately 2032. It is important to note that such projections are based upon the current constitutional framework and the outlook for growth within that context.

Table 2.8: Dependants per 1,000 persons of working age

<table>
<thead>
<tr>
<th></th>
<th>2012</th>
<th>2015</th>
<th>2020</th>
<th>2025</th>
<th>2030</th>
<th>2035</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scotland</td>
<td>588</td>
<td>582</td>
<td>561</td>
<td>598</td>
<td>646</td>
<td>663</td>
</tr>
<tr>
<td>UK</td>
<td>615</td>
<td>612</td>
<td>593</td>
<td>618</td>
<td>651</td>
<td>661</td>
</tr>
<tr>
<td>Difference</td>
<td>-27</td>
<td>-30</td>
<td>-32</td>
<td>-20</td>
<td>-5</td>
<td>2</td>
</tr>
</tbody>
</table>

Source: ONS, latest (2012 based) population projections for Scotland and the UK\textsuperscript{61}

2.61 While there is an increase in the older population, this is not unique to Scotland or the UK. Most countries, particularly advanced economies, face changes in the population structure due to ageing – some even more pronounced.

\textsuperscript{57} NRS 2010-based population projections are used for this comparison. While they are not fully comparable because of timing differences they provide a better comparison with Eurostat data, than the 2012-based population projections.

\textsuperscript{58} Eurostat data does not cover Croatia who joined in 2013.

\textsuperscript{59} The working age population in Scotland is projected to increase by 3.4% compared to 10.9% in the UK between 2012 and 2035.

\textsuperscript{60} Dependency ratios should be interpreted with a degree of caution. For example, the usual interpretation is the number of older people or children 'dependent' on people aged 16 to state pension age, the assumption being that the majority are economically inactive. The reality is more complex. For example, some people of working age are unemployed or economically inactive (e.g. in education) themselves, retirement age can vary and many retirees are financially independent. The ratios do however, provide a useful indication of the relative age structure of the population.

\textsuperscript{61} Note: The figures for working age and pensionable age take into account the increases in pension age set out in the 2011 Pensions Act. The data presented here does not reflect proposed further changes to the pension age published by the UK Government but not yet law. Further information can be found at: www.gov.uk/changes-state-pension.
2.62 For example, Table 2.9 presents the UK dependency ratio in comparison to a number of countries based on population projections produced by the UN. Whilst the UN projections are not directly comparable with the UK population projections produced by the Office for National Statistics (ONS) they do allow for global comparisons of changes in population structure to be made.

Table 2.9: Dependency ratio (Population aged 0-14 & 65+ per 100 population 15-64)\textsuperscript{62}

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2015</th>
<th>2020</th>
<th>2025</th>
<th>2030</th>
<th>2035</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>48.3</td>
<td>49.4</td>
<td>52.1</td>
<td>57.2</td>
<td>64.1</td>
<td>70.1</td>
</tr>
<tr>
<td>Belgium</td>
<td>51.4</td>
<td>55.7</td>
<td>59.3</td>
<td>63.2</td>
<td>67.3</td>
<td>70.6</td>
</tr>
<tr>
<td>Germany</td>
<td>52.0</td>
<td>52.4</td>
<td>56.3</td>
<td>61.8</td>
<td>70.2</td>
<td>77.8</td>
</tr>
<tr>
<td>New Zealand</td>
<td>50.4</td>
<td>53.2</td>
<td>56.5</td>
<td>59.3</td>
<td>63.0</td>
<td>65.1</td>
</tr>
<tr>
<td>Sweden</td>
<td>53.2</td>
<td>59.5</td>
<td>63.1</td>
<td>65.2</td>
<td>66.9</td>
<td>68.3</td>
</tr>
<tr>
<td>UK</td>
<td>51.9</td>
<td>55.5</td>
<td>58.2</td>
<td>60.1</td>
<td>63.6</td>
<td>66.7</td>
</tr>
<tr>
<td>US</td>
<td>49.0</td>
<td>51.7</td>
<td>55.5</td>
<td>60.2</td>
<td>63.9</td>
<td>65.4</td>
</tr>
</tbody>
</table>


\textbf{Income Inequality}

2.63 There is a recognition that an economy’s ability to tackle inequalities is not only important in its own right, but also for a country’s long-term economic growth potential.

2.64 The Fiscal Commission Working Group was clear about inequality in the UK and its impacts: “Such patterns of inequality will continue to have a negative impact on growth and prosperity in the long-term”.\textsuperscript{63}

2.65 Gini coefficients are a widely used measure of income inequality in a society. They range between 0 and 1, with higher Gini values indicating greater inequality.\textsuperscript{64}

2.66 The latest international comparisons relate to 2010 – Table 2.10. On these figures, the UK has one of the lowest levels of income equality in the OECD (ranked 28th).\textsuperscript{65} Small –

\textsuperscript{62} The UN produces population projections every two years. The projections allow global comparisons of changes in population structure across a wider group of countries. http://esa.un.org/wpp/Excel-Data/EXCEL_FILES/1_Population/WPP2012_POP_F11_A_TOTAL_DEPENDENCY_RATIO_1564.XLS


\textsuperscript{64} The Gini coefficient represents a measure of the cumulative income share against the share of households in the population. It ranges between 0 and 100 with 0 indicating total equality of income and 100 indicating total inequality (if one household had all the income).
and particularly Scandinavian – countries dominate the top 10 (i.e. have the lowest income inequality).

**Table 2.10: Gini Coefficient (after taxes and benefits) across OECD countries and Scotland, 2010**

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
<th>Gini Coefficient</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Iceland</td>
<td>0.24</td>
</tr>
<tr>
<td>2</td>
<td>Slovenia</td>
<td>0.25</td>
</tr>
<tr>
<td>3</td>
<td>Norway</td>
<td>0.25</td>
</tr>
<tr>
<td>4</td>
<td>Denmark</td>
<td>0.25</td>
</tr>
<tr>
<td>5</td>
<td>Czech Republic</td>
<td>0.26</td>
</tr>
<tr>
<td>6</td>
<td>Finland</td>
<td>0.26</td>
</tr>
<tr>
<td>7</td>
<td>Slovak Republic</td>
<td>0.26</td>
</tr>
<tr>
<td>8</td>
<td>Belgium</td>
<td>0.26</td>
</tr>
<tr>
<td>9</td>
<td>Austria</td>
<td>0.27</td>
</tr>
<tr>
<td>10</td>
<td>Sweden</td>
<td>0.27</td>
</tr>
<tr>
<td>17*</td>
<td>Scotland</td>
<td>0.30</td>
</tr>
<tr>
<td>28</td>
<td>United Kingdom</td>
<td>0.34</td>
</tr>
</tbody>
</table>

Source: OECD/ Scottish Government *Scotland is excluded from the explicit ranking of the 34 OECD member states

2.67 As the Fiscal Commission Working Group identified, despite a period of economic growth, income inequality in the UK has widened. In 2011, the OECD reported that income inequality among working age people increased more quickly in the UK than in any other OECD economy since 1975.

2.68 The ‘S90/S10 ratio’ is widely used to measure the gap between the average incomes of the richest 10% of the population and the poorest 10%. The ratio between the richest 10% and the poorest 10% is now 10:1 in the UK (above the OECD average of 9:1). Scotland

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65 In 2010 Spain was ranked 27th and Portugal was ranked 29th.
66 2010 data from OECD on international Gini comparisons. Where data not available, so 2009 figures used. Data for Scotland based on 2010-2011. Note, Scotland is excluded from the ranking of 34 OECD member states. The 2010/11 Gini coefficient for Scotland has been included for reference.
68 The S90/S10 ratio is the share of all income received by the top decile divided by the share of the first, or the ratio of the average income of the top decile to that of the first.
has a ratio of 7.5:1 meaning the gap between incomes is smaller and placing Scotland level with the Republic of Ireland and 7 places above the UK as a whole.\(^69\)

2.69 In 2011-12, 710,000 individuals in Scotland were living in relative poverty\(^70\) (i.e. those whose income is below 60% of the UK median income). The Scottish Government believes that this is too high. The relative poverty rate in Scotland (14% of the population) was slightly lower than the UK (16%).

2.70 Analysis shows that many of these individuals, and the communities that they live in, have been hit hardest in terms of income and employment during the recession.\(^71\)

2.71 Moreover, analysis predicts that those in poverty are likely to be especially vulnerable to upcoming changes in the UK welfare system with real and perceived barriers to employment and social inclusion likely to increase.\(^72\)

**Sustainability**

2.72 In the decades to come, climate change will be the biggest challenge that all economies will face.

2.73 All countries will have to adjust to greater environmental efficiency and sustainability. The Scottish economy is well placed to benefit however, both from the development of the low carbon economy and obtaining a comparative advantage from using Scotland’s natural resources more efficiently.

2.74 Successive administrations have aimed for Scotland to be a model for the international community in tackling climate change.

2.75 In 2011, Scottish greenhouse gas emissions,\(^73\) including international aviation and shipping and adjusted to take account of trading in the EU Emissions Trading System, were

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\(^69\) OECD Statistics 2010/11. Statistics for Scotland are from the Family Resources Survey, DWP

\(^70\) Relative poverty is calculated before housing costs

\(^71\) [http://www.shu.ac.uk/research/cresr/sites/shu.ac.uk/files/hitting-poorest-places-hardest_0.pdf](http://www.shu.ac.uk/research/cresr/sites/shu.ac.uk/files/hitting-poorest-places-hardest_0.pdf)

\(^72\) [http://www.jrf.org.uk/sites/files/jrf/MPSE%202012%20Bookmarked%20REVISED.pdf](http://www.jrf.org.uk/sites/files/jrf/MPSE%202012%20Bookmarked%20REVISED.pdf); and

[http://www.shu.ac.uk/research/cresr/sites/shu.ac.uk/files/hitting-poorest-places-hardest_0.pdf](http://www.shu.ac.uk/research/cresr/sites/shu.ac.uk/files/hitting-poorest-places-hardest_0.pdf)

\(^73\) The Scottish emissions figures presented do not include any emissions from the offshore oil and gas industry.
25.7% lower than in 1990.\textsuperscript{74} As a result, Scotland is more than halfway towards its Climate Change (Scotland) Act 2009 target of achieving at least a 42% emissions reduction by 2020.\textsuperscript{75}

2.76 Based on the percentage reduction in unadjusted emissions between 1990 and 2011, Scotland has had a larger reduction than any of the EU 15 member states\textsuperscript{76} and compared with the total for the EU-27 Member States.\textsuperscript{77}

2.77 A key challenge is to deliver sustainable economic growth. One way to examine this is through Carbon Productivity (the ratio of Greenhouse Gas emissions to GDP).

**Figure 2.11: Emissions (in tonnes of CO2e) - including Land Use, Land Use Change and Forestry per Million dollars GDP - (PPP), 2011\textsuperscript{78}**

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\textsuperscript{74} This figure has been adjusted for trading in the EU ETS. Unadjusted emissions have fallen by 29.6% since 1990. http://www.scotland.gov.uk/About/Performance/scotPerforms/purpose/sustainability


\textsuperscript{76} EU-15 area countries are: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden and United Kingdom.

\textsuperscript{77} http://www.scotland.gov.uk/Topics/Environment/climatechange/EUMemberState

\textsuperscript{78} Source: OECD for European countries; Scottish Government, for Scottish figures
2.78 Figure 2.11 above provides an international comparison showing the relationship between GDP and emissions for a group of key international comparators. In 2011 Scotland emitted 309 tonnes of CO2 equivalent per million dollars of GDP.\textsuperscript{79}

**Conclusions**

2.79 The analysis presented here confirms the conclusion of the Fiscal Commission Working Group that “by international standards Scotland is a wealthy and productive country.”

2.80 Since devolution, Scotland has narrowed the gap with the UK on a number of key indicators. However, the data also reveals key areas where Scotland’s performance could, and should, be better.

2.81 For example, while Scotland is on a par with the UK on aggregate indicators such as output per head, productivity and employment, many other comparable nations perform more strongly.

2.82 As highlighted throughout this report, the Scottish Government believes that there are also key weaknesses in the UK economic model, which threaten the stability of the Scottish economy in the long-run. Firstly, there is increasing income inequality both at the household and intra-UK regional level. Secondly, the growth model pursued by successive UK governments of high levels of consumption funded by borrowing at the expense of trade and investment, is not a solid base for sustainable growth.

2.83 Overall, the Scottish Government believes that there is nothing fundamental that limits Scotland reaching its full potential but simply that the lack of autonomy to take decisions to help Scotland succeed is a major disadvantage and constrains economic performance.

2.84 The next chapter considers the current economic framework and contrasts this with the offer available with independence.

\textsuperscript{79} International GDP comparisons from OECD calculated on a purchasing power parity basis
Chapter Summary

- Under the current constitutional settlement, the Scottish Parliament has a significant degree of autonomy in important areas related to the economy – including education, energy, skills, local economic development and transport.
- In the vast majority of areas however, ranging from taxation, welfare, regulation, consumer protection and the macroeconomic framework, policy is reserved to Westminster. It is set for the UK as a whole and does not, and cannot, consider any distinct circumstances or preferences in Scotland.
- The budget over which devolved policies are set is effectively a residual of policy choices made on spending in Whitehall Departments.
- Choices concerning the type of economy and society that shape a country, including the balance of public versus private enterprise, membership of the EU & relations with other countries, and the degree of income equality, are – to any meaningful extent – outside the remit of the Scottish Parliament.

Introduction

3.1 Next year the people of Scotland face a vote between two futures: the status quo and independence.

3.2 The differences, in terms of the responsibilities, opportunities and choices, are significant. This chapter summarises the current framework and the balance of devolved and reserved responsibilities, and contrasts this with independence.

3.3 Much of the debate so far has centred on the short-term.

3.4 While relevant, this ignores the essential point that next year’s decision will shape the future of Scotland for the long-term. The transition is important and needs to be handled carefully, but the focus should centre upon the long-term vision for the country and the risks and opportunities in delivering that vision under independence or Westminster.
3.5 The **current framework** is defined by the Scotland Act 1998 and the Scotland Act 2012 – Box 3.1 provides a summary of the division between Reserved (i.e. UK Government) and Devolved (i.e. Scottish Government) economic responsibilities.

3.6 This report takes the economic model for **independence** proposed by the Fiscal Commission Working Group.

<table>
<thead>
<tr>
<th>Box 3.1: Devolved and Reserved Economic Powers</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Reserved</strong></td>
</tr>
<tr>
<td>• Around 85% of taxation (e.g. National Insurance, income tax, capital gains tax &amp; corporation tax)</td>
</tr>
<tr>
<td>• Fiscal &amp; monetary policy</td>
</tr>
<tr>
<td>• Welfare (including unemployment, benefits)</td>
</tr>
<tr>
<td>• Tax credits (for businesses &amp; families)</td>
</tr>
<tr>
<td>• The minimum wage</td>
</tr>
<tr>
<td>• EU representation</td>
</tr>
<tr>
<td>• Economic &amp; Financial regulation</td>
</tr>
<tr>
<td>• Energy markets &amp; the North Sea</td>
</tr>
<tr>
<td>• Key aspects of environmental policy (including regulation and green taxes)</td>
</tr>
<tr>
<td>• Immigration</td>
</tr>
<tr>
<td>• Trade and industry, including competition, intellectual property, consumer protection &amp; Access to Finance</td>
</tr>
<tr>
<td>• Science and Innovation</td>
</tr>
<tr>
<td>• The Post Office</td>
</tr>
<tr>
<td>• Aspects of transport, including international air connectivity</td>
</tr>
<tr>
<td>• Employment Regulation</td>
</tr>
<tr>
<td><strong>Devolved</strong></td>
</tr>
<tr>
<td>• Education and training</td>
</tr>
<tr>
<td>• Local economic development</td>
</tr>
<tr>
<td>• Housing and Planning</td>
</tr>
<tr>
<td>• Health &amp; Social Care</td>
</tr>
<tr>
<td>• Tourism</td>
</tr>
<tr>
<td>• Aspects of transport, including road network</td>
</tr>
<tr>
<td>• Aspects of environment and climate change</td>
</tr>
<tr>
<td>• Aspects of agriculture, forestry and fishing</td>
</tr>
<tr>
<td>• Local taxation</td>
</tr>
</tbody>
</table>
Overall Shape of Economic Model

3.7 The economic performance of a country reflects a variety of factors. Some of these are pre-determined such as geography and natural resources. Others are built up over time, such as the skills-base of the workforce, infrastructure and international reputation.

3.8 The role of economic and social policy, and the institutions that deliver them, are fundamental. They influence for example, the degree of income inequality and a country’s approach to sustainability and economic resilience.

3.9 Strategic decisions include - the balance of public versus private enterprise, membership of international bodies and organisations (such as the EU), relations with other countries and the social-economic model pursued (for example the rights of employees).

3.10 Alongside this, specific policy decisions such as access to education, the level of taxation, the commitment to investment and productivity, help shape the structure of an economy and society.

3.11 This implies choices, opportunities and trade-offs. The right approach will vary by country. It will differ because of the preferences and priorities of the people who live there and the unique challenges and opportunities that their resources and economic and social history provide.

3.12 As a devolved administration, whose role and remit is limited by the UK Government, such fundamental decisions on the shape of the economy and society lie outside the direct control of Scotland.

3.13 Evidence suggests that there is the scope to deliver better outcomes – Box 3.2.

**Box 3.2: Indicators of Economic and Social Performance**

Chapter 2 highlighted how on certain key economic indicators the UK – and Scotland – has underperformed. This is confirmed by analysing broader measures of economic and social progress. They show that the overarching frameworks operating in other countries, and the specific policy propositions put forward, deliver better outcomes.

For example, the UN’s Human Development Index (HDI) is a composite index of measures
including life expectancy, educational attainment and income. The top ranked country in the 2012 HDI was Norway. The UK was joint 26th – just ahead of the Czech Republic and Greece.

Table 3.1 : UN Human Development Index (HDI), 2012

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
<th>HDI</th>
<th>Rank</th>
<th>Country</th>
<th>HDI</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Norway</td>
<td>0.955</td>
<td>16</td>
<td>Israel</td>
<td>0.9</td>
</tr>
<tr>
<td>2</td>
<td>Australia</td>
<td>0.938</td>
<td>17</td>
<td>Belgium</td>
<td>0.897</td>
</tr>
<tr>
<td>3</td>
<td>United States</td>
<td>0.937</td>
<td>=18</td>
<td>Austria</td>
<td>0.895</td>
</tr>
<tr>
<td>4</td>
<td>Netherlands</td>
<td>0.921</td>
<td>=18</td>
<td>Singapore</td>
<td>0.895</td>
</tr>
<tr>
<td>5</td>
<td>Germany</td>
<td>0.92</td>
<td>20</td>
<td>France</td>
<td>0.893</td>
</tr>
<tr>
<td>6</td>
<td>New Zealand</td>
<td>0.919</td>
<td>=21</td>
<td>Finland</td>
<td>0.892</td>
</tr>
<tr>
<td>=7</td>
<td>Ireland</td>
<td>0.916</td>
<td>=21</td>
<td>Slovenia</td>
<td>0.892</td>
</tr>
<tr>
<td>=7</td>
<td>Sweden</td>
<td>0.916</td>
<td>23</td>
<td>Spain</td>
<td>0.885</td>
</tr>
<tr>
<td>9</td>
<td>Switzerland</td>
<td>0.913</td>
<td>24</td>
<td>Liechtenstein</td>
<td>0.883</td>
</tr>
<tr>
<td>10</td>
<td>Japan</td>
<td>0.912</td>
<td>25</td>
<td>Italy</td>
<td>0.881</td>
</tr>
<tr>
<td>11</td>
<td>Canada</td>
<td>0.911</td>
<td>=26</td>
<td>Luxembourg</td>
<td>0.875</td>
</tr>
<tr>
<td>12</td>
<td>Korea, Republic of</td>
<td>0.909</td>
<td>=26</td>
<td>United Kingdom</td>
<td>0.875</td>
</tr>
<tr>
<td>=13</td>
<td>Hong Kong, China (SAR)</td>
<td>0.906</td>
<td>28</td>
<td>Czech Republic</td>
<td>0.873</td>
</tr>
<tr>
<td>=13</td>
<td>Iceland</td>
<td>0.906</td>
<td>29</td>
<td>Greece</td>
<td>0.860</td>
</tr>
<tr>
<td>15</td>
<td>Denmark</td>
<td>0.901</td>
<td>30</td>
<td>Brunei Darussalam</td>
<td>0.855</td>
</tr>
</tbody>
</table>


The evidence suggests that greater levels of equality and better social outcomes more generally do not harm competitiveness. For example, both Norway and Sweden have amongst the lowest levels of income inequality in the world, are ranked in the top 10 of the HDI and output per head, and are also ranked relatively highly in core indicators of economic competitiveness.\(^80\)

Their performance provides evidence that, if there is a willingness in society coupled with good policymaking, a stronger focus on social cohesion does not have to come at the expense of economic success.

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\(^80\) Caution should be exercised when using indicators of competitiveness as they are often highly subjective and rely upon a number of difficult to measure variables. The methodology used to develop each index also varies hence the wide spread in certain country rankings. However, taken as a collective group they can provide a helpful illustration of relative levels of competitiveness and comparisons across countries.
### Table 3.2: Select Comparison of International Social Justice and Competitiveness Measures

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Denmark</td>
<td>15</td>
<td>0.252</td>
<td>5</td>
<td>12</td>
<td>15</td>
</tr>
<tr>
<td>Finland</td>
<td>21</td>
<td>0.26</td>
<td>12</td>
<td>20</td>
<td>3</td>
</tr>
<tr>
<td>Ireland</td>
<td>7</td>
<td>0.331</td>
<td>15</td>
<td>17</td>
<td>28</td>
</tr>
<tr>
<td>New Zealand</td>
<td>6</td>
<td>0.317</td>
<td>3</td>
<td>25</td>
<td>18</td>
</tr>
<tr>
<td>Norway</td>
<td>1</td>
<td>0.249</td>
<td>9</td>
<td>6</td>
<td>11</td>
</tr>
<tr>
<td>Sweden</td>
<td>7</td>
<td>0.269</td>
<td>14</td>
<td>4</td>
<td>6</td>
</tr>
<tr>
<td>Switzerland</td>
<td>9</td>
<td>0.298</td>
<td>29</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>UK</td>
<td>26</td>
<td>0.341</td>
<td>10</td>
<td>18</td>
<td>10</td>
</tr>
</tbody>
</table>

### Macroeconomic Framework

3.14 The macroeconomic framework covers the structure and design for monetary policy (including currency), fiscal policy and financial stability.

3.15 All of these are linked and subject to interdependencies. A robust macroeconomy is essential in creating a supportive environment for trade, growth, employment and economic equality.

3.16 Under the **current framework** responsibility for the macroeconomic framework is reserved to the UK. With **independence**, future Scottish governments would be responsible for the design and implementation of the macroeconomic framework.  

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81 OECD Statistics – see Chapter 2.  
82 http://www.doingbusiness.org/reports/global-reports/doing-business-2014  
83 http://www.imd.org/wcc/news-wcy-ranking/  
84 http://www.weforum.org/node/47812  
Monetary Policy

3.17 The principal goal of monetary policy is to ensure price stability – i.e. low and manageable inflation – and subject to this being delivered, to help smooth the business cycle.

3.18 Under the current framework monetary policy is fully reserved. The Bank of England sets interest rates on behalf of the UK economy.\(^{86}\)

3.19 The Bank of England is operationally independent.\(^{87}\) In effect, this means that the day-to-day operation of monetary policy is discharged to the Bank. The Bank is formally accountable to the UK Parliament.

3.20 Under independence, the choice of monetary policy arrangements would sit with Scotland. The Fiscal Commission Working Group has proposed – and the Scottish Government agrees – that Scotland enter a formal monetary union with the UK.\(^{88}\)

3.21 Under such an arrangement, monetary policy would be set according to economic conditions across the Sterling Area with ownership and governance of the Bank of England undertaken on a shareholder basis.

Box 3.3: Choice of Currency Arrangements

The Fiscal Commission Working Group (FCWG) considered four currency options:

- Sterling
- Euro
- A Scottish currency pegged to Sterling
- A flexible Scottish currency

Following a detailed analysis of the various options, the Working Group:

"commends to the Scottish Government retaining Sterling as part of a formal monetary union, and believes that this provides a strong overarching..."

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\(^{86}\) Observation of spatial aspects in the performance of the UK economy is provided by the Bank of England’s network of Regional Agents.

\(^{87}\) The Bank of England was made operationally independent in 1997.

framework for Scotland post-independence."

Analysis highlights a number of key reasons why this would be in both Scotland and the UK’s interests post-independence.89

1. The UK is Scotland’s principal trading partner accounting for 2/3 of exports in 2011, whilst figures cited by HM Treasury suggest that Scotland is the UK’s 2nd largest trading partner with exports to Scotland greater than to Brazil, South Africa, Russia, India, China and Japan put together;90

2. There is clear evidence of companies operating in Scotland and the UK with complex and integrated cross-border supply chains;

3. A high degree of labour mobility – helped by transport links, culture and language;

4. On key measurements of optimal currency area, the Scottish and UK economies score well – for example, similar levels of productivity;

5. It would assist the transition to independence – including negotiations over allocation of assets and liabilities; and,

Evidence of economic cycles shows that while there have been periods of temporary divergence, there is a relatively high degree of short-term synchronicity.

3.22 The Scottish Government believes that this proposal is in the best interests of both Scotland and the UK and ensures a continued trading partnership across the British Isles.

Financial Stability and Financial Regulation

3.23 A well-functioning and robust financial system provides an important foundation for economic growth and stability. The recent crisis has highlighted the implications of any failure to properly regulate and monitor financial markets and institutions.

3.24 Under the current framework, regulation of financial services is reserved.

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3.25 The UK framework has recently undergone reform.\(^{91}\) This included the establishment of a Bank of England Financial Policy Committee to monitor systemic risk (macro-prudential regulation),\(^{92}\) and a Prudential Regulatory Authority to supervise major financial institutions (micro-prudential regulation). Alongside this, a Financial Conduct Authority was established to oversee the conduct of financial services firms – i.e. the relationship with customers.

3.26 With independence, Scotland would have its own regulatory framework. It would however, clearly reflect the modern and international nature of the financial services industry.

3.27 The Fiscal Commission Working Group set out recommendations for financial regulation as part of their view of a complete and comprehensive macroeconomic framework, taking account of the important role of financial stability in the modern economy.

3.28 Their proposed framework recognised the cross border nature of the financial services sector and built on the lessons of previous failures to adequately supervise and deal with systemically important financial institutions. The proposal drew on recent reforms to improve the resilience of the global financial sector and the clear trend toward greater cross border coordination in relation to overall stability and – when needed – crisis management.\(^{93}\) Importantly, their recommendations reflected the existence of significant ‘financial conglomerates and groups’ across Scotland and the UK.

3.29 The Fiscal Commission Working Group recommend that, as part of this Sterling Area framework, the Bank of England should continue to lead on overall financial stability with prudential regulation – both macro and micro – coordinated across the Sterling Area. There are a number of institutional arrangements for how this could be achieved.

3.30 Within this framework, aspects of financial regulation which relate to more local elements – in particular conduct – could be discharged by a Scottish regulator working in close partnership with the relevant UK regulators.

\(^{91}\) http://www.publications.parliament.uk/pa/bills/lbill/2012-2013/0025/2013025.pdf
\(^{92}\) http://www.bankofengland.co.uk/financialstability/Pages/fpc/default.aspx
\(^{93}\) The EU has for example made significant progress towards a Banking Union. A Single Supervisory Mechanism has already been agreed, giving the ECB oversight of the safety and soundness of the largest Euro Area banks. A Single Resolution Mechanism (SRM) is also being designed with a common system for deposit guarantee – or procedures for coordinating schemes – also part of the roadmap.
3.31 The Scottish Government has considered the options in detail and will shortly publish a detailed paper setting out a framework for financial regulation post-independence.

### Box 3.4: The Size of the Scottish Banking Sector

The size of Scotland's banking sector, and its role in the economy is often misunderstood.

A UK Government publication on financial services (May 2013) included analysis on the size of the banking sector in Scotland.  

It estimated that “Scottish” banking institutions assets amounted to £1.89 trillion (or 1,254% of GDP) out of total UK banking assets £7.45 trillion (or 25%). The paper asserted that this posed a risk to Scotland post-independence.

Such figures are however, backward looking and rely upon a number of highly challengeable assumptions.

Firstly, measures of the 'real' economic footprint of financial services in Scotland and the UK show that the sector is either in line or slightly smaller than the UK. Financial services contribute around 8 per cent to the onshore Scottish economy slightly less than 7 per cent including oil. This compares to a UK figure of 7.9%. In contrast, London accounts for just short of 50% of UK financial services GVA. There is also analysis available on the size of Scottish financial services within the UK. In 2010, Scotland accounted for 7.1% of UK financial services GVA, below a per capita share.  

Secondly, regulatory reforms will break the link between key elements of bank balance sheets and taxpayers. For example, in response to the recommendations of the Vickers report, the Banking Reform Bill is due to come into force in early 2014 and will separate the more risky element of banks from their traditional retail based functions by 2019.

Thirdly, the calculations depend critically on the identification of ‘Scottish financial services’. These issues are complex. To obtain a figure close to £1.89 trillion, a large proportion of the assets ‘allocated’ to Scotland inflate any reasonable measure by including assets from investment banking arms - despite the economic footprint of such activities occurring largely outside Scotland and will soon be ring-fenced – and undertaking a select interpretation of the geographical allocation of assets of UK Banking Groups.

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94 UK Government (May 2013) Scotland analysis: Financial services and banking  

95 Sources: Scottish National Account Project (SNAP), Scottish Government, and Regional Accounts, ONS.
Such issues are best highlighted by the fact that in a recent experimental series of tax revenue statistics, HMRC estimated Scotland’s share of the Bank Levy (a charge on the balance sheets of banks) to be 7.3% of the UK total.\textsuperscript{96} This is 1/3 of the 25% required to be consistent with this earlier analysis by HM Treasury.

**Fiscal Policy**

3.32 The management of the public finances, through decisions on the levels of public sector spending, revenue raising and borrowing, is key to a successful economy.

3.33 Under the **current framework**, the overarching fiscal framework is set by the UK Government. This not only includes the overall fiscal stance, but the mechanism through which spending is allocated to the Scottish Government – the Barnett formula.

3.34 Under **independence** responsibility for the public finances would represent one of the principal new levers open to future Scottish governments.

3.35 At the foundation of a successful fiscal framework is a system which ensures that public sector debt and borrowing are well managed. Only if this is achieved can fiscal policy be effective in supporting the economy and greater equity.

3.36 Under **independence** future Scottish governments would be required to establish a framework that promoted fiscal sustainability.\textsuperscript{97}

3.37 The Fiscal Commission Working Group has highlighted a number of features that should underpin such a framework\textsuperscript{98} -

- Fiscal Rules to promote discipline and ensure that the public finances are on a transparent and sustainable path;

- A Scottish Fiscal Commission to provide independent advice and scrutiny;

- A stabilisation and long-term savings fund to manage Scotland’s oil wealth; and,

\textsuperscript{96} See http://www.hmrc.gov.uk/statistics/receipts/disagg-method.pdf

\textsuperscript{97} Box 4.8 provides reflections on the UK’s track record on fiscal management

\textsuperscript{98} Fiscal Commission Working Group (2013) Fiscal Rules and Fiscal Commissions

http://www.scotland.gov.uk/Publications/2013/11/4732
• A ‘fiscal sustainability agreement’ to promote stability within the Sterling Area.

3.38 Within this, future Scottish governments would be able to determine the size of the revenues available for public spending and the full range of spending priorities.

**Microeconomic Framework**

3.39 Broadly speaking, the microeconomic framework covers the policy choices which influence and shape incentives and behaviours at the sector, firm, household or individual level. They can also affect the performance of social policies and levels of well-being.

3.40 Table 3.3 groups these broad policies into four categories:

- **Taxation** – business, consumption, income and wealth taxation, sector specific taxes, duties; and the use of credits and allowances.

- **Public Spending** – spending priorities and policies, procurement and borrowing.

- **Regulatory Levers** – levers to set and enforce market rules – including the labour market, consumer protection, competition and intellectual property.

- **Institutions & Representation** – indirect policy levers – including the design of institutions and the approach to international engagement and representation.

3.41 Clearly there are significant overlaps between these policy areas. Possible linkages cannot be fully considered under the **current framework** but could under **independence**.
### Table 3.3: Overview of the Microeconomic framework

<table>
<thead>
<tr>
<th>Taxation</th>
<th>Public Spending</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Corporation Tax</td>
<td>• Welfare</td>
</tr>
<tr>
<td>• Income tax</td>
<td>• Infrastructure</td>
</tr>
<tr>
<td>• National Insurance</td>
<td>• Borrowing</td>
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<td>• Oil and Gas Taxation</td>
<td>• Procurement</td>
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<td>• Capital Gains Tax</td>
<td>• Education and Skills</td>
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<tr>
<td>• Value Added Tax (VAT)</td>
<td>• Economic Development</td>
</tr>
<tr>
<td>• Tax Credits and Allowances</td>
<td>• Transport</td>
</tr>
<tr>
<td>• Excise Duty</td>
<td>• Health</td>
</tr>
<tr>
<td>• Air Passenger Duty</td>
<td>• Housing</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Regulatory Levers</th>
<th>Institutions and Representation</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Competition</td>
<td>• Governance and institutions</td>
</tr>
<tr>
<td>• Consumer Protection</td>
<td>• Social Capital</td>
</tr>
<tr>
<td>• Industry Regulation</td>
<td>• Administration</td>
</tr>
<tr>
<td>• Employment Legislation and the Minimum Wage</td>
<td>• EU Representation</td>
</tr>
<tr>
<td>• Energy Markets and Regulation</td>
<td>• International Trade</td>
</tr>
<tr>
<td>• Company Law and Insolvency</td>
<td>• Foreign Policy</td>
</tr>
<tr>
<td>• Intellectual Property</td>
<td>• Responsible capitalism</td>
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<tr>
<td>• Environmental Regulation</td>
<td></td>
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<tr>
<td>• Planning</td>
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</tbody>
</table>

### Taxation

3.42 Under the **current framework**, Scotland has limited tax autonomy with responsibility restricted to local taxation (i.e. council tax and business rates), accounting for just 7% of taxes collected in Scotland. All other taxes are set for the UK as a whole.\(^99\)

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3.43 The Scotland Act 2012 will provide a limited increase in tax powers – including a Land and Buildings Transaction Tax, to replace Stamp Duty Land Tax, and a Scottish Landfill Tax to replace the equivalent UK tax. From April 2016, a Scottish Rate of Income Tax (SRIT) will be introduced.\textsuperscript{100}

3.44 Even after the financial provisions of the Scotland Act 2012 are fully implemented, the UK will retain responsibility for approximately 85% of revenues collected.

3.45 Responsibility for designing and setting the level of taxes, particularly those which have the greatest impact on economic growth, the income distribution, environmental sustainability and behaviour change, are reserved. Evidence suggests that many people in Scotland favour the Scottish Parliament having greater responsibility for taxation (and welfare).\textsuperscript{101}

Figure 3.1: Scottish Tax Receipts, 2011-2012

\textsuperscript{100} The Calman Commission on Scottish Devolution also recommended the devolution of Air Passenger Duty and Aggregates Levy: http://www.commissiononscottishdevolution.org.uk/. Despite this, the UK Government has yet to make substantive progress on devolving these taxes.

\textsuperscript{101} The 2012 Scottish Social Attitudes Survey showed that 56% of people were in favour of the Scottish Parliament making decisions about the level of taxes, and 64% were in favour of welfare being set by the Scottish Parliament. Source: Scottish Social Attitudes Survey 2012 http://whatscotlandthinks.org/questions/who-ought-to-make-most-important-decisions-for-scotland-about-taxes#table; and http://whatscotlandthinks.org/questions/who-ought-to-make-most-important-decisions-for-scotland-about-welfare-benefits#table
3.46 Under independence, future Scottish governments would be responsible for all taxes raised and collected in Scotland. Box 3.5 provides a short summary of some of the current revenues collected in the UK.

3.47 Independence would provide an opportunity to reform the current UK tax system. A system that the Fiscal Commission Working Group described as being “complex and costly”,\textsuperscript{102} and the chair of the UK Parliament’s Committee of Public Accounts has called “hopelessly complex and outdated”.\textsuperscript{103}

**Box 3.5: Key Additional Tax Levers under Independence**

Scotland would inherit the UK tax system upon independence, but would have the opportunity to reform it over time. Indeed the Fiscal Commission Working Group has stated that “a re-designed Scottish tax system could represent a major competitive advantage, offering a more robust and efficient tax system than key competitors”.

However, the current system provides a helpful starting point to identify the types of tax levers that, in principle, could be deployed. There are currently over 30 major taxes raised in the UK including –

**Corporation Tax** – The core tax on profits and the headline ‘business tax’. In addition to the rate, the base – i.e. incentives for investment and R&D – is important for economic activity.

**Income Tax** – Paid on earned income (e.g. wages) and unearned income (e.g. savings and investments). The tax rate varies according to the level and source of income. It has a key role in the labour market, welfare, and overall progressivity of the tax system.

**National Insurance Contributions** – Collected from both employees and employers. They are, in effect, a tax on wages and are notionally attached to elements of social security (e.g. pensions). Like income taxes they have important links to the labour market.

**Capital Gains Tax** – A tax on gains in wealth (e.g. when shares or property are sold).

**Value Added Tax (VAT)** – A ‘sales’ tax currently with a standard rate of 20% applying to most products, although reduced or zero rates apply to some goods and services and a small number are exempt entirely.


\textsuperscript{103} http://www.parliament.uk/business/committees/committees-a-z/commons-select/public-accounts-committee/news/tax-avoidance-the-role-of-large-accountancy-firms/
**Excise Duties** – Levied – often in addition to VAT – on certain activities. In most cases, the products are deemed to have negative externalities (e.g. alcohol, gambling and tobacco).

**Environmental Taxes** – So-called ‘green’ taxes designed to incentivise sustainable activities and/or discourage harmful activities (e.g. Climate Change and Aggregates Levies).

**Oil and Gas Taxation** – A specific tax regime for oil and gas to capture ‘economic rents’. There are three elements to the North Sea tax framework - Petroleum Revenue Tax, Corporation Tax and the Supplementary Charge.

**Other smaller taxes** – include taxes such as Air Passenger Duty which is levied on air transport, and the Insurance Premium Tax (a tax on general insurance products).

**Public Spending**

3.48  The **current framework** grants the Scottish Government autonomy over the allocation of approximately 60% of public spending – covering areas such as education and skills, transport, planning and local economic development.

3.49  Within this, there is a substantial degree of autonomy both in terms of the size of the remit and the ability to determine devolved policy priorities and strategies.

3.50  The choices taken in these areas have a significant impact on economic and social outcomes.
3.51 Under independence, Scotland would have additional responsibilities across a range of areas. These include science and innovation, welfare, child support and pensions, foreign affairs and defence.

3.52 Welfare is by far the most substantial. In 2012-13, the UK Government is forecast to control spending of around £18 billion on benefits in Scotland. The Scottish Government and local authorities also provides welfare in a wider sense, for example through social work and social care services at an additional cost of approximately £5 billion.

3.53 Welfare covers a range of interventions – Box 3.6 summarises existing benefits, some of which are scheduled to change following the implementation of Universal Credit, Personal Independence Payment, and wider UK welfare reforms.

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**Box 3.6: Welfare Policies in the UK**

Benefits under the current framework can (broadly speaking) be categorised as follows –

*Benefits for out of work people* – Income Support, In Work Credit & Return to Work Credit, Job Grant & Jobseekers Allowance.

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### Benefits for older people
- State Pension, Pension Credit, TV Licences & Winter Fuel Payments.

### Benefits for people who are ill or disabled
- Attendance Allowance, Carer’s Allowance, Disability Living Allowance, Employment & Support Allowance, Industrial Injuries, Personal Independence Payment, Severe Disablement Allowance & Statutory Sick Pay.

### Benefits for families with children
- Child Benefit, Child Tax Credit, Maternity Allowance & Statutory Maternity Pay.

### Benefits for people on low incomes

Other
- Bereavement benefits, Christmas bonus, and other small benefits such as Cold Weather Payment, etc.

The introduction of Universal Credit will result in the replacement of many working-age benefits. Personal Independence Payment is being phased in as a replacement for Disability Living Allowance for working age recipients.

3.54 It is through welfare that governments support vulnerable people, provide protection in times of economic and personal challenge and shape and influence behaviours.

3.55 The Scottish Government has established an Expert Working Group on Welfare to consider the options for Scotland’s welfare system and its delivery post-independence.\(^{105}\)

3.56 Under the **current framework** the Scottish Government has limited borrowing autonomy to support and prioritise spending over time.

3.57 The Scotland Act 2012 will enable limited borrowing by the Scottish Government from 2015/16. Scottish Ministers will be able to borrow for capital purposes up to a cumulative maximum of £2.2 billion. HM Treasury has capped annual borrowing at 10% of the Scottish Government capital budget (approximately £296 million in 2015-16).\(^{106}\) Revenue borrowing will only be available to smooth fluctuations in tax receipts relative to forecasts and be subject to a cumulative maximum of £500 million and/or £200 million in any one year.

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\(^{105}\) More information on the Expert Working Group on Welfare can be found at: [http://www.scotland.gov.uk/Topics/People/welfarereform/EXPERTWORKINGGROUPONWELFARE](http://www.scotland.gov.uk/Topics/People/welfarereform/EXPERTWORKINGGROUPONWELFARE)

3.58 Under independence, future Scottish governments would be responsible for managing borrowing in a prudent manner.

**Regulatory Levers**

3.59 Economic regulation is a key lever in supporting the efficient functioning of markets in a mixed economy. Effective and proportionate regulation is vital to correct market failures, promote competition and to help businesses and innovation prosper.

3.60 For example, authorities assess the competitiveness of markets and ensure that any mergers and acquisitions do not distort the market or create dominant positions. As part of the drive toward completing the EU Single Market, key aspects of regulation are harmonised across Europe and national regulatory bodies are monitored closely to ensure that their activities do not act as a barrier to trade or competition.

3.61 Under the **current framework**, the majority of regulatory levers are reserved.

3.62 Key decisions on vital markets such as energy, telecoms and postal services, are taken with a UK view only. In many cases this will be appropriate, but in some cases, it will mean that Scotland’s distinct circumstances – for example, its geography or economic strengths/challenges – are not adequately taken into account.

3.63 It is estimated that the UK has the least restrictive frameworks for product regulation in the OECD (with the exception of the USA). This has advantages, but also disadvantages. For example, minimising regulation can encourage competition, innovation and efficiency; however, a lack of suitable regulation can result in markets that do not always work in the best interests of consumers, and which may be actively harmful to them in the worst instances. Striking the right balance between regulation and free markets is essential, and a decision on what level of regulation is appropriate for Scotland could only take place under **independence**.

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3.64 At the same time, some markets, in terms of the concentration of activity, can vary between Scotland and the UK. For example the nature of the retail banking, and the challenges it faces, in Scotland is different from the UK.\textsuperscript{108}

3.65 Intellectual property, which provides rights to creators of new ideas and is a key driver of innovation and research, is reserved to the UK. This is also the case for employment regulation, industrial regulation and corporate law.

3.66 Under independence, future Scottish governments would have access to the full set of regulatory levers – Box 3.7.

\begin{table}[h]
\centering
\begin{tabular}{|p{15cm}|}
\hline
\textbf{Box 3.7: Regulatory Levers} \\
\hline
The regulatory framework aims to support the efficient functioning of markets whilst also providing safeguards for consumers.  
\textbf{Competition Law} – This aims to remove barriers which prevent well-functioning markets, such as anti-competitive behaviour (e.g. monopoly power/collusion), merger and acquisition activity that inhibits competition or a lack of choice in the marketplace.  
\textbf{Financial Regulation} – Financial markets have a key role in a modern economy. Their stability is of paramount importance. At the same time, they happen to incur some of the greatest market failures, such as moral hazard and asymmetric information. They are therefore subject to regulation both for stability and conduct purposes.  
\textbf{Consumer Protection} – This aims to promote consumer rights and protect them from unfair treatment. This allows markets to operate effectively, ensures that the vulnerable are protected and guards against market abuse.  
\textbf{Industry Regulation} – Like financial services, a range of particular industries receive specific regulation, beyond general competition and consumer policies. These generally include sectors which involve national infrastructure and/or the market only provides a small number of firms. These include energy, telecommunications, postal services and rail.  
\textbf{Employment Regulation} – Employment legislation aims to provide protection to workers. It includes minimum pay, health and safety, holiday entitlements and redundancy rules. \\
\hline
\end{tabular}
\end{table}

\textsuperscript{108} Sustainable, Responsible Banking: A strategy for Scotland
http://www.scotland.gov.uk/Publications/2013/05/3325
Company Law and Insolvency – The regulation of corporations covers issues such as governance (e.g. rights and duties of shareholders), finance (e.g. reporting practices) and insolvency (e.g. procedures for rescuing companies or distributing assets).

Intellectual Property – IP law provides rights to creators and innovators. Common types of property rights include copyright, trademarks, patents and industrial design rights.

Institutions and Representation

3.67 Alongside the traditional economic policy levers, such as taxation and regulation, there is a growing body of evidence that the degree of social capital in a country is just as important.\(^{109}\) This includes a country’s attractiveness as a place to live and work, the efficiency of its political, economic and social institutions, the rule of law and interactions with the international community.

3.68 Successful well-functioning economies are underpinned by robust institutional structures.

3.69 High quality institutions that interact well with each other help shape expectations and behaviours, allowing individuals and firms to have confidence in the economic systems and legal framework in which they interact day-to-day.

3.70 Independence, by its very nature, would be the only constitutional arrangement which provided Scotland with determination of the entire system. In principle, it would create the potential to develop a comprehensive and cohesive governance structure for Scotland.

3.71 Sir John Elvidge, a former Permanent Secretary of the Scottish Government, in reviewing the governance and administrative arrangements for Scotland has stated that "independence constitutes an opportunity, on this as on other aspects of governance, to consider from first principles the nature of parts of the system and the relationships between them".\(^ {110}\)

3.72 Scotland has built a strong reputation for highly respected institutions.

\(^{109}\) Social Capital and Regional Economies in Britain, Casey, Political Studies Volume 52, Issue 1, March 2004

\(^{110}\) Scotland’s Future – The economics of constitutional change, 2013, (Chapter 11, Sir John Elvidge, p277)
3.73 Smaller countries tend to differ from larger countries in a number of important ways. In particular, they tend to develop quite particular structures and institutions – with greater sharing of responsibilities by institutions – that are not simply smaller versions of larger countries.

3.74 In a modern economy, and as Chapter 9 discusses in more detail, it is not just domestic bodies that are important but also a country’s international institutions.

3.75 Under the current framework, Scotland has some opportunities to form strategic economic alliances and partnerships. It lacks however, the authority of an independent nation.

3.76 With independence, Scotland would have full responsibility for international engagement, including with the EU. This would extend Scottish representation and influence on EU policies.

3.77 An independent Scotland would have full responsibility for trade promotion and foreign policy, and would be able to consider the potential linkages across such areas.

3.78 The ability to use ‘soft power’ is important. Scotland could look to countries such as Ireland, Finland and New Zealand who, while comparable in size, have been able to use their distinct place on the international stage to their substantial advantage.

3.79 Finally, an advantage of economic autonomy – demonstrated through the current framework – is the knowledge base and shared approach that can develop from scrutiny and robust debate. It has been highlighted that one of the features of devolution has been a greater understanding and convergence in thinking around what the key challenges and opportunities are for the Scottish economy in the years ahead.111

3.80 While political preferences will clearly differ – particularly around priorities, policy responses and the constitutional framework – the understanding of the drivers of growth in Scotland and the country’s comparative advantages are arguably now more widely recognised. This can be an advantage and helps ensure a shared narrative and broadly consistent policy approach over a sustained period of time. This can bring confidence to investors and provide greater certainty and stability.

111 Scotland’s Future – The economics of constitutional change, 2013, (Page 71, Professor Andrew Goudie).
Chapter 4: Assessing the Options

Chapter Summary

- The Scottish Government believes that independence is the best option for Scotland.
- Independence would mean that policy priorities could be matched with the specific needs and circumstances of the Scottish economy – both in the short-term and long-term – creating a clear accountable link between the development of policy and the performance of the economy.
- It would also mean that decisions – often tough decisions – were taken by the people living and working in Scotland and who have the greatest stake in the future success of the Scottish economy.
- With these new opportunities would come additional responsibilities and the need to prioritise choices.

Introduction

4.1 In this chapter, the current framework and independence are reviewed against two key criteria set out by the Fiscal Commission Working Group –

- **Long-term competitiveness** – maximising opportunities to raise productivity, competitiveness and economic growth over the long-term; and

- **Short-run responsiveness** – maximising opportunities to respond swiftly and effectively to changes in circumstances

Box 4.1: Assessment Criteria

**Long-term Competitiveness**
An economic framework that enhances long-term competitiveness is vital to delivering sustainable economic growth. Key criteria include -

- The degree of autonomy to tailor policies to distinct circumstances of the Scottish economy;
- The breadth of opportunities to extend competitive advantages; and
- The efficiency of the delivery of public services and the degree of accountability and transparency.
Short-run Responsiveness
The ability to respond flexibly to changing economic circumstances is of critical importance. Key criteria include -
- Macroeconomic stability;
- Budgetary Stability & Affordability; and
- Flexibility

Long-term Competitiveness

4.2 In an increasingly integrated global economy, establishing and maintaining a competitive advantage is vital. The powers of independence themselves cannot bring about a guaranteed outcome – but instead it is how effectively the policies of independence are used.

The degree of autonomy to tailor policies to the distinct circumstances of the Scottish economy

4.3 Under independence, future Scottish governments would have the maximum degree of autonomy to tailor policies to the distinct circumstances of Scotland’s economy.

4.4 In contrast, and as Chapter 3 highlighted, responsibility for key economic and social polices is reserved under the current framework. These include science and innovation, welfare, foreign affairs, regulation and consumer protection. As Figure 4.1 demonstrates, from a purely fiscal perspective, the degree of autonomy is highly constrained.

4.5 Moreover under the current framework, the nature of the funding settlement means that Scottish Budgets are determined principally by changes in London. The autonomy provided by devolution is therefore constrained beyond what would initially appear to be the case with additional practical limits on the opportunity to vary policy.

112 For example, cuts to English education budgets feed through to overall Scottish budgets via the Barnett Formula.
However the, albeit limited, ability of successive administrations to tailor policy to the needs and strengths of the Scottish economy under devolution has helped to strengthen Scotland’s performance within the UK since 1999 – as illustrated in Box 2.2. The Scottish Government believes that this demonstrates the benefits of greater economic self-determination.

For example, Ernst and Young have argued that Scotland’s success in attracting international investment can be explained, in part, by the fact that “Scotland’s voice — as promoted by the proactive efforts of Scottish Development International (SDI) and the Scottish Government — is being heard all the more clearly by investors all over the world”,\textsuperscript{113} whilst a study undertaken by Cardiff University, Queens University Belfast, Robert Gordon University and Birmingham University concluded that “devolution has played a significant role in the expansion of renewable energy deployment in the UK, with Scotland leading the way on renewable energy delivery”\textsuperscript{114}


\textsuperscript{114} http://www.cardiff.ac.uk/news/articles/devolution-is-driving-force-behind-uk-renewable-energy-agenda-10148.html
4.8 **Independence** would create a unique opportunity to pursue a distinct economic model that reflected the preferences of the Scottish people and which made the best use of Scotland’s assets.

4.9 Instead, retaining the **current framework** would mean that key aspects of policy continued to be developed from a UK perspective. As the Fiscal Commission Working Group highlighted, it is not necessarily the case that such policies are wrong but simply that they cannot always consider Scotland’s interests.

4.10 Of course, all policy choices would have to consider funding and be balanced alongside competing priorities. But such responsibility is part of being independent and can itself help deliver more effective outcomes.

**The breadth of opportunities to extend competitive advantages**

4.11 Increasing competitiveness is vital to creating a faster growing economy and supporting more and better paid jobs and better public services.

4.12 Public policy has an important role. Investment in capital, both physical and human, and research and development are essential drivers of productivity and growth.

4.13 Under the **current framework**, the Scottish Government has some responsibility for key elements of supply-side economic policy, including education, skills and infrastructure which can extend competitive advantages.

4.14 However, **independence** would give access to more tools to enhance Scotland’s competitive edge. For example, **independence** would provide the Scottish Parliament with the opportunity to shape the regulatory framework and the tax environment to make the most of Scotland’s natural economic advantages.

4.15 As Chapter 5 sets out, this is particularly important in the context of the business environment where, for example, careful use of tax powers can be highly effective - Box 4.2.

4.16 The institutional environment could also be reformed to reflect Scotland’s circumstances. For example, as set out in the recent Fiscal Commission Working Group
report, independence would provide a unique opportunity to design a more efficient tax system and which was designed to complement the strengths of the Scottish economy.

### Box 4.2: Taxation and Scotland's Competitive Advantage

In addition to the development of Scotland’s human capital and natural resources, efficient use of taxation can be an important policy tool.

The Fiscal Commission Working Group provided a series of helpful recommendations regarding the use of tax powers including –

- The Scottish Government should design a tax system built around Scottish circumstances and preferences to help increase productivity and economic growth while meeting the needs of the people of Scotland.
- The tax and welfare systems are key levers for tackling inequality – both are strongly interlinked and should be considered as fundamentally part of the same system. Welfare and tax policy should therefore be developed in tandem to ensure policy integration and alignment.
- Appropriate tax rates maximise receipts by creating the optimal level of economic activity and revenue raising potential. The Scottish Government should assess the optimal balance of tax rates and bases for key taxes, such as business and employee taxes, and levels of government spending.

An open and consultative approach with the industry, independent experts, employer groups, and the general public, should be adopted when designing and reviewing the effectiveness of tax administrative policy to ensure the system is comprehensive, inclusive and maximises compliance.

4.17 Under independence, Scotland would have more opportunity to develop nuances within policy to support local competitive advantages and to tackle comparative disadvantages by targeting areas of priority which may understandably differ from those in other parts of the UK.

4.18 The Scottish Government believes that inability to extend competitive advantages under the current framework poses significant risks in an economic model where the focus

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of activity and priority of policymaking is more and more concentrated in London and the South East – Box 4.3.

**Box 4.3: Pattern of Regional Growth in the UK**

The UK has one of the most regionally unbalanced economies in the world. In 2011, output per head in London was over 70% higher than the UK average.

In contrast, output per head in Wales and the North East in 2011 were nearly 25% below the UK average.

Figure 4.2 looks at income distribution across a range of European countries by NUTS 3 region. The income distribution in the UK is highly unequal, driven by very large incomes generated in Inner London. This contrasts to the more even income distribution seen in the Nordic countries where income levels in the lowest regions and the national income level are higher than those found in the UK, but where the highest income regions are not dramatically richer than the rest of the country.

**Figure 4.2: Geographic income distribution in European countries (2010)**

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The Scottish Government believes that such imbalances are not sustainable. However under successive UK governments they have widened and become more embedded.

In the run up to the financial crisis, London and the South East grew much more quickly than the rest of the UK, driven by a boom in financial services and rising house prices. The downturn did not reverse such trends. Indeed, over the period 2007-2011 output grew more quickly in London and the South East than elsewhere.

**Figure 4.3: GVA Growth by Government Office Region, 2007-2011**

The figures show that Scotland has managed to fare slightly better than other parts of the UK, helped in part by the opportunities to pursue distinct approaches in devolved areas including a national economic recovery plan. But London continues to dominate and trends suggest that this only likely to increase.

4.19 This demonstrates a lack of stability and balance in the UK economy which, given current trends and the direction of policy, is likely to only increase in the years ahead. The Scottish Government believes that this poses a significant risk to Scotland’s economy over the long-term.

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The efficiency of the delivery of public services and the degree of accountability and transparency

4.20 The efficient delivery of policy can make an important contribution to economic success. It has been argued that good policy making is best achieved when there are clear choices and trade-offs on both spending and revenue. The lack of balance between expenditure and revenue is widely regarded as one of the key weaknesses of the current framework.

4.21 Transparency can also lead to better policy making and boost accountability.

4.22 As argued in Chapter 3, successive administrations in Scotland have built a reputation for effective policymaking in devolved areas of responsibility. For example, in 2011 71% of people indicated that they trusted the Scottish Government to act in Scotland’s best interests, compared to 18% who trusted the UK Government.

4.23 Under the current framework, successive Scottish governments have been able to use their local knowledge to respond to demands and priorities. This arguably explains recent economic successes and the improved understanding of the Scottish economy since devolution.

4.24 As highlighted by the Fiscal Commission Working Group however, under the current framework the complex mix of responsibilities limits the scope for synergies, and reduces the ability of Scottish Governments to recycle the benefit from successful policy delivery.

4.25 For example additional spending on social housing by the Scottish Government helps to reduce rents and as a result leads to lower housing benefit payments in Scotland. The cost of additional social housing is met by the Scottish Government, whilst the savings from lower housing benefit payments are retained by the UK Government. Under independence

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120 For example, the coverage of data for the Scottish economy – while still imperfect and short of what would be available under independence is much superior to that for English regions.
the benefits would provide savings to the Scottish Government helping to meet the cost of expenditure on social housing.

4.26 Under independence, the Scottish Government believes that the full range of economic levers – taxation, public investment, employment law, economic regulation and existing devolved responsibilities – could be utilised in a more coherent and joined-up way.

4.27 It has been claimed that if regulations, taxes and economic policies were to differ between Scotland and the UK, this may lead to inefficiencies and trade barriers. However, such concerns are likely to be ‘overestimated’. 122

4.28 Firstly, the nature of the modern global economy and the institutions which shape trade and relations between countries (such as the EU) ensures that so-called ‘border’ effects are greatly reduced. Scotland will remain part of the EU and the largest single market in the world – with no trade barriers and the free movement of goods & services and people.

4.29 Secondly, while a distinct institutional framework may limit opportunities to take advantage of economies of scale arising from common service provision, on the other hand, a heavily centralised administration can itself carry significant costs and lead to inefficiencies. The Scottish Government believes that independence would actually improve efficiency.

4.30 Thirdly, under the current framework decisions can be taken in reserved areas which do not reflect the democratic views of the people in Scotland. The proposed changes underway as part of the UK Government’s welfare reform programme illustrate this point.

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122 Scotland Analysis: Macroeconomic and fiscal performance, HM Treasury, September 2013 (Page 118). The lack of a comparable counterfactual means that any application of the experience in other countries to the Scottish and UK context is likely to overestimate any impact. For example, there is no effective Single Market between the USA and Canada unlike Scotland and the UK; comparisons with the Euro Area are influenced by economic geography and important cultural and language barriers which act to limit trade but which would not be relevant to Scotland. At the same time, the creation of the Czech Republic and Slovakia occurred when both countries were moving from a planned to a market economy and for Ireland independence was followed by a substantial increase in protectionist measures – none of these would exist in the Scottish case. The analysis that has therefore been undertaken to project a so-called ‘border effect’ is therefore unlikely to give an accurate picture of the reality of Sco-rUK trade links post-independence.
Box 4.4: Impact of UK Government Welfare Reform

As Chapter 2 highlighted, the UK has high levels of inequality.

In 2011-12, 15% of children and 13% of working-age adults in Scotland lived in relative income poverty (16% of children and 15% of working-age adults in absolute income poverty).\(^{123}\)

The UK programme of welfare reform could exacerbate these trends. IFS projections suggest that, based on the current policy mix and macroeconomic forecasts, the number of children and working-age adults in Scotland in relative income poverty could increase to 22.7% and 16.9%, respectively, by 2020.\(^{124}\)

The IFS also estimates that the benefit and tax reforms enacted between 2010 and 2015 could reduce household net income in Scotland by nearly 3%.\(^{125}\)

Moreover, Scottish Government analysis estimates that:

- The cumulative impact of the package of welfare reforms over the five years to 2014-15 could result in Scottish welfare support being reduced by over £4.5 billion.\(^{126}\)
- When the present welfare reforms have come into full effect they will take more than £1.6 billion a year out of the Scottish economy.\(^{127}\)

Under the current devolution settlement, the Scottish Government has limited financial and legal powers to offset these policies.

For example, in response to the “Bedroom Tax”, while limited support can be diverted to mitigate the worst effects (e.g. the government re-directed £20 million in 2013-14), the Scottish Parliament cannot intervene in a reserved area. Moreover, any resources used come at the expense of devolved priorities. At the same time, it is Scottish authorities

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\(^{126}\) Since June 2010 DWP have announced a number of changes to the welfare budget, beginning with 2010 Emergency Budget and culminating most recently in the 2013 Budget. The cuts are spread across the benefit system with only pensioners being exempt. More information is available at: http://www.scotland.gov.uk/Topics/People/welfarereform/analysis/welfareexpenditurecuts

(particularly local government and the third sector) who are left to deal with many of the wider consequences.

4.31 Under independence, future Scottish governments and Scottish parliaments would be fully responsible for tackling the key challenges Scotland will face in the years ahead. The Scottish Government would be accountable for the benefits (such as increased tax revenues) of good policymaking and just as accountable for the costs of poor policymaking.

4.32 Finally, independence would also provide the opportunity to design institutions and deliver public services in a manner most appropriate for Scotland.

4.33 It is important to note that Scotland currently contributes to existing UK Government spending commitments via general taxation. Under independence, many of these responsibilities would transfer from Whitehall to Scotland leading to a direct benefit in terms of jobs and economic activity. Edinburgh would become a fully recognised capital city with all the responsibilities and activities that this would present. There would also be spin-off benefits for cities across the country. Scotland’s international exposure – and the global awareness of Scotland – would increase.

4.34 A key opportunity with independence would be the potential for Scotland to exploit its size to design institutions and to deliver public services in a manner which incorporated a greater partnership approach to policy development and implementation – Box 4.5.

Box 4.5: Partnership Working to Promote Sustainable and Inclusive Growth

“Economic growth requires mutually beneficial cooperation – it is a collective action problem. A society characterised by generalised trust and reciprocity will be adept at addressing such problems, increasing aggregate economic gains.”

A cooperative and partnership approach could help Scotland better achieve its potential, by ensuring that all key players – public sector organisations, trade unions, business groups, employers and the third sector – were partners in delivering a common vision.

It can be argued that such an approach – a stronger partnership model – is more achievable in a smaller rather than a larger country.

128 Social Capital and Regional Economies in Britain, Casey, 2004
Scotland already has high levels of social capital and respected institutions.

However, independence would present the opportunity for a step change by allowing a greater social partnership approach to be rolled out across all aspects of economic and social policy.

For example, the Fiscal Commission Working Group recommended an open and consultative approach with industry, experts, employer groups, and the public on taxation with the aim of being comprehensive, inclusive and maximising compliance.

The Team Scotland Approach is an example of how Scotland has been able to use the powers within the current framework to exploit its size to form successful partnerships and joint strategies. It is a concerted effort by public sector bodies to join forces and work together in the Scottish interest, beyond the sole responsibility of any one partner.

This can include joint marketing efforts promoting Scotland and the Scottish economy or securing major investments or events. Key players alongside central and local government include Scottish Enterprise and Highlands & Islands Enterprise, Scottish Development International, VisitScotland, Skills Development Scotland (SDS), and the Scottish Funding Council.

The approach often extends to business, third sector and trade unions where a concerted effort is made to promote Scotland.

**Short-run responsiveness**

4.35 The ability to respond swiftly and flexibly to changing economic needs and circumstances is important in determining the ability of a country to stabilise its economy and protect long-term sustainability. A key aim is to, wherever possible, help minimise negative shocks and enable a stronger, faster recovery.

**Macroeconomic stability**

4.36 As recent events have demonstrated, the economy is always exposed to a degree of instability.
4.37 The Scottish Government believes that what is important is who is best placed to meet such challenges – Scottish governments with the balance of levers focussed on what is in the interests of the Scottish people and Scottish economy, or the UK Government who have a set of UK-wide objectives.

4.38 Under the current framework, responsibility for macroeconomic policy rests with the UK Government.

4.39 In the context of stabilisation, pooling of risk can sometimes be an advantage. However, a ‘one-size-fits-all’ approach limits the flexibility to respond at a distinctive Scottish level to changes in the economic climate.

4.40 As outlined by the Fiscal Commission Working Group, the trade-off in terms of risk-pooling versus autonomy depends, in part, upon the degree of commonality in business cycles and exposure to asymmetric shocks.

4.41 Given the close economic linkages and the evidence of similar business cycles between Scotland and the UK, under independence the Scottish Government believes that there will be an improved mix of stabilisation policy. Some aspects – in particular with regard to monetary policy and financial stability – will be coordinated across the Sterling Area, while other aspects, such as fiscal policy will be targeted toward the unique circumstances facing Scotland.

4.42 The Fiscal Commission Working Group has outlined how this balance of coordination and autonomy could be handled through the appropriate design of institutions. For example, a Sterling Area Sustainability Agreement and effective local institutions such as an independent Scottish Fiscal Commission.

4.43 The proposed framework for independence could allow Scotland to improve on the UK’s track-record of macroeconomic stability.

4.44 Indeed, a key objective for Scotland must be to create a more stable macroeconomic environment. As a partner in a monetary union this will be important. Scotland will need a framework that guards against local asymmetric shocks and which has in place mechanisms
to deal with them if they were to occur\textsuperscript{129}. It will also need to respond to instances when the UK takes a different path – for example a rapid increase in public or private debt – and take the tough decision to act more responsibly\textsuperscript{130}.

4.45 For example, a key challenge for future independent Scottish governments will be to counter the apparent preference across many policymakers in the UK for ever higher levels of debt. This arguably reflects, in part, a mistaken belief of the scale and importance of the UK in the global economy that such debts can continue to be financed indefinitely and also an apparent accompanying preference toward inflation. A more sustainable and responsible approach in Scotland could yield a number of advantages, not only by providing a contrast to financial markets and investors of the benefits of economic responsibility but also in terms of long-run competitiveness.

**Box 4.6: The UK’s Performance through the Recession**

In 1997, the UK Government committed to end ‘boom and bust’. For the best part of a decade, the UK economy performed strongly. However, with hindsight it was clearly built on weak foundations with a highly leveraged financial sector, growth concentrated in a small part of the country, a decline in industrial output, a current account deficit and a house price bubble.

The UK experienced a recessionary contraction of 7.2\% during 2008 and 2009, greater than the decline of 5.6\% in Scotland. Despite being nearly five years after the downturn started, as at 2013 Q2, the UK economy remained 3.3\% below its pre-recession peak (with Scotland 1.4\% below).

Some countries, such as Ireland and Iceland, suffered even greater recessions\textsuperscript{131}. This reflects however, not their size, but poor economic policy decisions in the run up to the crisis. Larger countries – such as Spain – have suffered badly as well. It is interesting that, even

\textsuperscript{129} Arguably the most important potential such shock is an oil shock, which is why the Fiscal Commission Working Group’s proposals for two funds to mitigate this are particularly helpful and relevant – Box 4.10.

\textsuperscript{130} The role that a Scottish Fiscal Commission would play is set out by the Fiscal Commission Working Group on Fiscal Rules and Fiscal Commissions: http://www.scotland.gov.uk/Publications/2013/11/4732

\textsuperscript{131} Iceland and Ireland are interesting case studies. While suffering severe financial crises and likely to face a further period of adjustment, they are also putting in place the fundamentals, such as an export led recovery that will stand them well in the years ahead.
despite the challenges, Ireland’s GNI per capita was 97% of the UK equivalent in 2012 (compared to 75% in 1980)\textsuperscript{132} and in terms of GDP per capita, Ireland is forecast to be 20% higher than the UK by 2018.\textsuperscript{133}

**Figure 4.4: Recession - Total Peak to Trough Decline in GDP**

**Figure 4.5: Recovery - Q2 2013 Compared to Pre-recession Peak**


\textsuperscript{133} Source: IMF, World Economic Outlook Database
At the same time, it is important to note that while some countries have witnessed falls in GDP of around 10 – 15%, output in some parts of the UK is permanently lower and by even greater margins. For example, as highlighted in Box 4.3, output per head in Wales is some 25% lower than the UK average and has been lower since the series began in 1997.

Real household incomes have fallen in Scotland and the UK since the recession.\(^{134}\)

The Scottish Government believes that the key driver of economic success over the long-term is taking on full responsibility during the good times and bad.

4.46 Many of the significant imbalances which make the UK vulnerable to macroeconomic instability remain.

4.47 In 2010, UK Government's \emph{Plan for Growth}\(^{135}\) identified a number of challenges. The report stated that –

- Growth has been unbalanced and concentrated in London and the South East and the financial services industry; with analysis suggesting that regional differences in GDP per capita are greater in the UK than in any other EU country;
- Growth has been unsustainable and debt-driven. More than a quarter of the GDP per capita growth in the pre-crisis decade to 2007 was reversed during the financial crisis and recession of 2008 and 2009, and the UK was left amongst the most indebted nations in the world; and
- Over this period, the UK’s performance in a number of fields – including exports, manufacturing, educational attainment, and competitiveness – relative to its competitors has worsened.

\begin{quote}
“Our economy has become more and more unbalanced, with our fortunes hitched to a few industries in one corner of the country, while we let other sectors like manufacturing slide.”
\end{quote}

(Prime Minister David Cameron, Speech on the Economy, 2010)\(^{136}\)

\(^{134}\) Source: HBAI dataset, DWP. Over the period 2009/10 to 2011/12 real median equivalised household incomes fell by approximately 5.5% in Scotland and approximately 6% in the UK.


Box 4.7: UK Rebalancing

The gap in regional economic performance has widened through the recession rather than narrowed. For example, London accounted for nearly 22% of the increase in UK employment over the period Jan-Mar 2010 to Jul-Sep 2013.

Table 4.1: Changes in Employment, Jan-Mar 2010 to Jul-Sep 2013

<table>
<thead>
<tr>
<th></th>
<th>Employment growth, 2010 Q1 - 2013 Q3</th>
<th>Share of UK Employment growth, 2010 Q1 - 2013 Q3</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td>4.0%</td>
<td>-</td>
</tr>
<tr>
<td>London</td>
<td>6.8%</td>
<td>21.9%</td>
</tr>
<tr>
<td>East of England</td>
<td>6.9%</td>
<td>16.5%</td>
</tr>
<tr>
<td>South East</td>
<td>4.4%</td>
<td>15.8%</td>
</tr>
<tr>
<td>Yorkshire and the Humber</td>
<td>4.6%</td>
<td>9.7%</td>
</tr>
<tr>
<td>Scotland</td>
<td>4.5%</td>
<td>9.6%</td>
</tr>
<tr>
<td>West Midlands</td>
<td>1.1%</td>
<td>2.4%</td>
</tr>
<tr>
<td>North East</td>
<td>2.2%</td>
<td>2.2%</td>
</tr>
<tr>
<td>North West</td>
<td>-0.1%</td>
<td>-0.3%</td>
</tr>
</tbody>
</table>


The UK remains one of the most heavily indebted nations in the world. The OECD estimated that UK household debt as a proportion of disposable income was 160% in 2011, the second highest rate in the G7 (after Canada), and significantly higher than the G7 average of 122% in the same year.\textsuperscript{137} Debt across all sectors of the economy has risen and remains high.

\textsuperscript{137} OECD (2013) OECD Economic Outlook No. 93 (database)
The rebalancing between industry and services has yet to take place.\(^{138}\)

Over the period 1970 to 2011, manufacturing’s share of UK output declined from 29% to around 11%. In 2011, UK manufacturing output was just 2.4% above 1990 levels.\(^{139}\) Table 4.2 shows that there is a positive correlation between manufacturing and other outcomes such as investment and R&D.

**Table 4.2: International Comparisons Across a Range of Indicators (2011)**

<table>
<thead>
<tr>
<th>Country</th>
<th>Manufacturing output as % of GVA</th>
<th>Business Investment as % of GDP</th>
<th>Exports as % of GDP</th>
<th>Business Expenditure on Research and Development (BERD) as % of GDP</th>
<th>% Change in manufacturing GVA 1990-2011 (2005 prices)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>18.7</td>
<td>15.4</td>
<td>57.3</td>
<td>1.9</td>
<td>71.5</td>
</tr>
<tr>
<td>Denmark</td>
<td>10.9</td>
<td>10.3</td>
<td>53.8</td>
<td>2.1</td>
<td>11.2</td>
</tr>
<tr>
<td>Finland</td>
<td>17.3</td>
<td>9.9</td>
<td>40.7</td>
<td>2.7</td>
<td>105.8</td>
</tr>
<tr>
<td>Germany</td>
<td>22.6</td>
<td>10.3</td>
<td>50.2</td>
<td>1.9</td>
<td>29.5</td>
</tr>
<tr>
<td>Sweden</td>
<td>16.8</td>
<td>11.9</td>
<td>49.9</td>
<td>2.3</td>
<td>154.7</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>10.8</td>
<td>8.2</td>
<td>32.5</td>
<td>1.1</td>
<td>2.4</td>
</tr>
</tbody>
</table>

Source: UNCTAD, Eurostat, OECD.\(^{140}\)

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\(^{139}\) As at 2012 UK manufacturing output was 1.2% below 1990 levels. For example, The Dysfunctional UK Economy: A macroeconomic assessment of whether the UK economy is strong and secure, Margaret Cuthbert, June 2013, http://reidfoundation.org/wp-content/uploads/2013/06/Dysfunction1.pdf

\(^{140}\) Most recent data is 2011 to ensure comparability across series.
Recent data suggests that there is little evidence of such trends changing – with manufacturing growth lagging growth in services.

**Figure 4.7: Change in UK GVA by Sector, to Q2 2013**

<table>
<thead>
<tr>
<th>Sector</th>
<th>Growth since recession trough (2009 Q3)</th>
<th>Change from pre-recession high (2008 Q2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Production</td>
<td>-10%</td>
<td>-15%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>-5%</td>
<td>-10%</td>
</tr>
<tr>
<td>Construction</td>
<td>-10%</td>
<td>-15%</td>
</tr>
<tr>
<td>Services</td>
<td>0%</td>
<td>-5%</td>
</tr>
<tr>
<td>Total GVA</td>
<td>5%</td>
<td>10%</td>
</tr>
</tbody>
</table>

Source: Scottish Government

4.49 On the basis of the above evidence the UK is clearly failing to rebalance its economy to a more sustainable model, with the reliance on the service sector increasing, continued weakness in the manufacturing sector, increased levels of debt and further concentration of investment and policy focus in London and the South East.

**Budget Stability & Affordability**

4.50 A key challenge for Scotland, as with any country, is delivering a framework which ensures that the public finances are managed effectively. Like all responsible governments choices will need to be prioritised.

4.51 As a result of both the economic downturn and the fiscal management of successive UK governments, irrespective of the outcome of the referendum, Scotland will face a challenging fiscal position – Box 4.11.

4.52 Under the **current framework**, Scotland is dependent upon decisions taken by the UK Government both to manage the overall public finances responsibly and to allocate a budget for devolved spending.

4.53 The nature of the funding settlement means that the affordability of public services and economic and social policies in Scotland under the **current framework** is largely driven
by the strength of the UK public finances. A brief discussion of the UK’s track record is provided in Box 4.8.

**Box 4.8: The UK’s Recent Record on the Public Finances**

Between 1998-99 and 2000-01, the UK ran a budget surplus. However, despite the operation of two fiscal rules which promised "lock in a framework which guarantees sound finances", the UK Government ran a deficit each year from 2001-02 to 2007-08. Whilst the economy grew by 21% over this period, public sector debt increased every year.

The underlying strength of the UK’s public finances was weakened. As a result, the UK entered recession in 2007 with the highest structural deficit in the G7, and the third highest structural deficit in the OECD as a whole. Consequently, the UK was ill prepared for the financial crisis.

**Figure 4.8: General Government Cyclically-Adjusted Balances, 2007**

![Chart showing General Government Cyclically-Adjusted Balances, 2007](chart)

Source: OECD

4.54 Under current plans, the Scottish Government Budget is facing real terms cuts in every year from 2010-11 to 2017-18.

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141 For more detailed analysis of the UK Public Finances please see the Fiscal Commission Working Group Report, “Fiscal Rules and Fiscal Commissions”.

142 1998 Budget Statement

4.55 The UK Government could decide to replace Barnett in the future. Pressure may well come from outside Scotland for such a change.

4.56 One possibility could be to move towards a ‘needs assessment’ with funding linked to subjective measures of spending ‘need’. If this was to occur, the Scottish Government believes that there would be significant political pressure to use such an exercise to reduce Scotland’s Budget – Box 4.9.

**Box 4.9: Risks to Future Scottish Government Budgets**

The budgets of the Scottish Government, the Northern Ireland Executive and Welsh Assembly Government are all determined by the operation of the Barnett Formula, and are therefore based on population shares and historical spending allocations.

There have been a range of proposals put forward for reform, including greater own source funding via tax devolution and assignment of revenues. Proposals for a revised grant based funding framework more closely linked to a “needs” assessment exercise have also been proposed.

Under a needs based assessment, the level of funding for the Scottish Government would be linked to predetermined measures of “need”. Such assessments are complex and largely subjective.

If a “new” grant mechanism was constructed to more closely equalise devolved expenditure between English regions and the countries of the UK, then the block grant transferred to Scotland is likely to decrease, leading to potential further real cuts in funding despite Scotland contributing more in taxation per head over a sustained period of time. For example, the needs based assessment conducted by the Independent Commission on Funding and Finance for Wales suggested that spending in Scotland could be cut by up to £4 billion in one year.

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143 See for example the IPPR Devo More project (http://www.ippr.org/research-project/44/10218/devo-more-extending-devolution-and-strengthening-the-union) and the Devoplus campaign (http://www.devoplus.com)

144 http://wales.gov.uk/funding/financereform/report/?lang=en

145 Financial Times (5 July 2010) – David Miles and Gerald Holtham - Scotland is taking more than its share of funds, http://www.ft.com/cms/s/0/eaf6198-8865-11df-aade-00144feabdc0.html#axzz2hxnCkaDI
It is important to note however, that alternative assessments using different measures of need would lead to significant variations in funding outcomes. Scotland’s ability to influence these assessments in the event of a ‘no’ vote is likely to be extremely limited.

4.57 Under independence, future Scottish governments would be responsible for managing the public finances.

4.58 Like many other countries, restoring the public finances to health will be a key challenge and would have to be a top priority in the short to medium term.

4.59 However, such adjustments have taken place before and independence would have a number of distinct advantages over the status quo.

4.60 Firstly, subject to the broad parameters of any Sterling Area sustainability agreement, independence would provide the opportunity to design a path of fiscal adjustment most appropriate to the needs of, and conditions facing, the Scottish economy.

4.61 Secondly, the focus of any adjustment could be structured according to the values and priorities of the people of Scotland. For example, decisions could be taken on the burden sharing between the richest and poorest in society.

4.62 Thirdly, if future Scottish governments were able to use the new economic powers to grow the economy more quickly, then the proceeds could be used to support the public finances.

4.63 A key objective for an independent Scotland would be to ensure that the tax revenues generated from oil and gas production in the North Sea were managed in a sustainable manner – Box 4.10.

**Box 4.10: Stabilisation and Savings Funds For Scotland**

In October 2012, the Fiscal Commission Working Group published their Stabilisation and Savings Funds for Scotland report. 146

146 http://www.scotland.gov.uk/Publications/2013/10/7805
Scotland’s oil and gas wealth is substantial. The Working Group estimated that – taking the current constitutional settlement as given – if Scotland had established an oil fund in 1980-81, and taking the time path of subsequent revenues and spending as given, Scotland could have accumulated financial assets of between £82 billion and £116 billion by 2011-12.

The Working Group recommended the establishment of two funds – a short-term stabilisation fund and long-term savings fund.

The stabilisation fund would aim to provide a mechanism to smooth the budget from year on year variations in oil and gas revenues.

The longer-term savings fund would aim to encourage a proportion of the tax revenue generated from oil and gas to be saved in order to benefit future generations with the first modest investments made when borrowing was at a sustainable level.

4.64 There has been much debate about the relative strength of Scotland’s public finances – see Box 4.11. Most studies conclude that, including a geographical share of North Sea revenues, Scotland’s public finances, are currently in a relatively stronger position that those of the UK.

4.65 The future path of an independent Scotland’s public finances will depend upon policy choices of future Scottish governments. For example, priorities such as defence vis-à-vis welfare spending. It will also depend upon economic performance and long-term trends such as demographic change.

Box 4.11: Scotland's Public Finances

A detailed analysis of Scotland’s estimated public finances – under the current constitutional framework – can be found in: “Scotland’s Balance Sheet” published in April 2013.147

The National Statistics publication Government Expenditure and Revenue Scotland (GERS) provides a comprehensive analysis of all public spending undertaken for the benefit of Scotland, and all tax revenue estimated to be generated from economic activity in Scotland.

As GERS takes the current constitutional framework as given, it is limited in what it can and cannot say about independence. Post-independence, not only will the fundamental structures of the Scottish economy change, but tax and spending choices will differ.

For 2011-12 (the most recent year available)\textsuperscript{148} –

- Public spending for Scotland was estimated to be equivalent to 42.7% of GDP, including a geographic share of North Sea output – slightly lower than the UK (45.5%);

- Estimated total (onshore and offshore) Scottish tax revenues were equivalent to £10,700 per person, compared to £9,000 per person for the UK;

- On a per capita basis, total tax revenues in Scotland are estimated to have been higher than in the UK in each year since 1980-81; and,

- Scotland is estimated to have had a net fiscal deficit worth around 5% of GDP in 2011-12 compared to a UK deficit of 7.9%.

GERS provides estimates of annual net flows. It does not contain an estimate of Scotland’s share of UK public sector assets, or liabilities such as public sector net debt.

At the end of 2011-12, UK public sector net debt was equivalent to £1.1 trillion (or 72% of GDP).

For illustrative purposes, two methods of assigning a share of the financing of such debt to Scotland are shown. A per capita share equivalent to £92 billion (or 62% of Scottish GDP) or a share based upon Scotland’s historical net positive contribution equivalent to £56 billion (or 38% of GDP) as summarised in the chart below.\textsuperscript{149}

\textsuperscript{148} All numbers include an illustrative geographical share of the North Sea oil, unless otherwise stated.

\textsuperscript{149} This historical calculation is based upon the estimated balance of revenues and expenditures since 1980, the first year for which statistics are available. Further information on this calculation is provided in the Scotland’s Balance Sheet report - http://www.scotland.gov.uk/Publications/2013/06/9241/0
On a per capita basis, debt, whilst lower than the UK’s, would however be higher than the average in recent decades, and will be higher than the average for countries of Scotland’s size. A historical share would be more in line with countries of a comparable size.

Looking ahead, it is clear that the UK public finances remain in a fragile state. For example, the latest long term forecasts by the Office for Budget Responsibility estimate that, based on current plans, the UK will be in deficit for every year between 2012-13 and 2062-63.\textsuperscript{150}

A key challenge for Scotland will be restoring the public finances to a more sustainable position. This should not be seen as a weakness. Greater fiscal responsibility than the UK has demonstrated in the past could be a real comparative advantage.

\textbf{Flexibility}

4.66 Under the \textbf{current framework}, the key policy levers related to short-term responsiveness are reserved to the UK Government.

4.67 As highlighted above, there is a trade-off between temporary pooling of resources and flexibility. On the one hand, a centralised system can allow for temporary transfers from more prosperous parts to relatively poorer areas. However, a reliance upon such ‘transfers’

\textsuperscript{150} Long Term Fiscal Sustainability Report, July 2013, Office for Budget Responsibility (OBR)
run the risk of locking areas into permanent lower levels of growth. Long-term economic development is unlikely to be achieved on a sustainable basis by transfers and redistribution alone.

4.68 The current framework constrains the ability of the Scottish Government to respond to economic shocks and changes in circumstances. The events of recent years provide a case study – Box 4.12.

**Box 4.12: Flexibility in Capital Spending During the Recession**

The Scottish Government believes that one recent example of where the lack of flexibility is demonstrated is capital investment. In 2010, the UK Government announced that the relative burden of fiscal consolidation would be skewed toward capital – including a 36% real terms cut in Scotland between 2010-11 and 2015-16. Subsequent budget revisions have mitigated some of the impact with the cut now set to be 26.6%.

The Scottish Government, along with the other Devolved Administrations, repeatedly called for a different approach.\(^{151}\) It was argued that while resource spending restraint was necessary, such drastic cuts to capital investment would only damage the recovery and the public finances. Analysis by both the OBR and IMF has suggested that the long-term fiscal multiplier on capital spending is higher than for other types of spending.\(^ {152}\)

The public sector in Scotland did what it could to support capital spending – including utilising local authority prudential borrowing opportunities, innovative approaches to private finance through the NPD model, acceleration of planned programmes and switching money to capital budgets.

Despite repeated requests for prioritisation of capital investment, it was not until the Autumn Statement in December 2012 that action was taken to mitigate some of the cuts to capital budgets.\(^ {153}\)

The decision by the UK Government to cut capital spending so quickly and sharply was a mistake. Borrowing overshot original forecasts whilst growth has underperformed (for example, the OBR forecast growth of 2.8% 2012 but actual growth turned out to be 0.1%).

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4.69 Under independence Scotland would have the ability to use the full range of levers (such as capital spending to support construction) flexibly to tackle problems and areas which were underperforming relative to the rest of the economy.

**Box 4.13: Taking Advantage of the Global Economy**

It is argued that being a small independent country in the global economy carries risks as well as opportunities.

In a globally interconnected world all countries are affected by economic shocks, and exchange rate movements.

It is true that some small economies – such as Ireland and Iceland – have suffered significant recessions.

However, it is also the case that many small countries have performed more strongly than the UK over the recession. In times of volatility and change, small countries can use their size to respond quickly and flexibly to changing economic conditions.

For example, GDP in Norway and Sweden in 2013 Q2 was 2.2% and 3.3%, respectively, above pre-recession levels. The fiscal positions – debt as a share of GDP for instance – and other macroeconomic indicators of smaller countries (with the exception of Iceland and Ireland which have had well-documented issues) are often stronger than many larger economies including the UK – Table 4.3.
Table 4.3: Macroeconomic Indicators of Selected European Countries

<table>
<thead>
<tr>
<th></th>
<th>Pop* (000s)</th>
<th>Inflation</th>
<th>Deficit/ Surplus</th>
<th>Bond Yield*</th>
<th>Gross Debt to GDP ratio</th>
<th>Credit Rating *</th>
<th>Employ Rate</th>
<th>GDP per capita ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Norway</td>
<td>5,051</td>
<td>0.4</td>
<td>+13.6</td>
<td>2.5</td>
<td>34%</td>
<td>AAA</td>
<td>76%</td>
<td>65,638</td>
</tr>
<tr>
<td>Iceland</td>
<td>322</td>
<td>6</td>
<td>-3.8</td>
<td>5.7</td>
<td>99%</td>
<td>BBB</td>
<td>80%</td>
<td>37,569</td>
</tr>
<tr>
<td>L’Aubour</td>
<td>537</td>
<td>2.9</td>
<td>-0.6</td>
<td>1.7</td>
<td>21%</td>
<td>AAA</td>
<td>66%</td>
<td>88,276</td>
</tr>
<tr>
<td>Ireland</td>
<td>4,591</td>
<td>1.9</td>
<td>-8.2</td>
<td>3.9</td>
<td>117%</td>
<td>BBB+</td>
<td>59%</td>
<td>43,670</td>
</tr>
<tr>
<td>Finland</td>
<td>5,427</td>
<td>3.2</td>
<td>-1.8</td>
<td>1.8</td>
<td>54%</td>
<td>AAA</td>
<td>70%</td>
<td>38,282</td>
</tr>
<tr>
<td>Denmark</td>
<td>5,603</td>
<td>2.4</td>
<td>-4.1</td>
<td>1.7</td>
<td>46%</td>
<td>AAA</td>
<td>73%</td>
<td>42,176</td>
</tr>
<tr>
<td>Austria</td>
<td>8,452</td>
<td>2.6</td>
<td>-2.5</td>
<td>2.0</td>
<td>74%</td>
<td>AAA</td>
<td>73%</td>
<td>43,848</td>
</tr>
<tr>
<td>Sweden</td>
<td>9,556</td>
<td>0.9</td>
<td>-0.2</td>
<td>2.1</td>
<td>38%</td>
<td>AAA</td>
<td>74%</td>
<td>43,017</td>
</tr>
<tr>
<td>UK</td>
<td>63,730</td>
<td>2.8</td>
<td>-6.1</td>
<td>2.4</td>
<td>89%</td>
<td>AA+</td>
<td>69%</td>
<td>37,446</td>
</tr>
<tr>
<td>France</td>
<td>65,633</td>
<td>2.2</td>
<td>-4.8</td>
<td>2.2</td>
<td>90%</td>
<td>AA+</td>
<td>64%</td>
<td>36,249</td>
</tr>
<tr>
<td>Germany</td>
<td>82,021</td>
<td>2.1</td>
<td>+0.1</td>
<td>1.5</td>
<td>82%</td>
<td>AAA</td>
<td>73%</td>
<td>41,231</td>
</tr>
</tbody>
</table>

All figures 2012 unless otherwise stated. * = 2013

As the table highlights, many small countries run more responsible macroeconomic policies than larger economies. This can have significant benefits over the long-run such as lower inflation and cheaper borrowing costs. For example, Finland, Denmark and Sweden currently face lower longer-term borrowing costs (on 10 year bond yields) relative to the UK.

Conclusions

4.70 Scotland currently has responsibilities for a number of areas which influence long-term performance. However, the Scottish Government and Scottish Parliament lack the full suite of economic levers. The Scottish Government believes that this puts Scotland at a significant disadvantage relative to comparable independent nations.

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Population: Eurostat, Population on 1 January 2013
Inflation: Eurostat, HICP, 2012 inflation rate, annual average rate of change (%)
Deficit/ Surplus: Eurostat, 2012, General government deficit/surplus % of GDP
Bond Yield: OECD, Monthly Monetary and Financial Indicators, long term (10 year) government bond yields, average Jan-Oct 2013
Gross Debt-GDP Ratio: IMF, World Economic Outlook Database, October 2013
Credit Rating: Fitch Ratings, T&C Sovereign Rating, Nov 2013
Employment Rate: OECD (15+), UK from the Annual Population Survey (16+), 2012 annual rate
GDP per Capita: OECD, 2012, GDP per capita (USD, current prices and current PPPs)
4.71 Whilst devolution has allowed successive Scottish governments to address certain specific challenges – and arguably help narrow the gap in performance with the UK – ultimately the economic structure is a direct result of decisions taken outside Scotland.

4.72 The Scottish Government believes that the evidence suggests that aspects of the growth model pursued by successive UK governments are unsustainable and leave the Scottish economy vulnerable to future internal and external economic pressures.

4.73 Independence would provide an opportunity to take a different approach, to grow Scotland’s economy in a more sustainable manner and to boost economic resilience and stability.

4.74 In a complex and increasingly competitive global economy, maintaining a competitive edge is essential. The economic self-determination that would come with independence would provide more opportunities to be responsive and adaptable to economic trends and to pursue economic – and environmental and social – objectives more effectively.

4.75 There will be challenges, not least in restoring the public finances to health and unravelling decades of under-investment in the economy. Competing priorities will require to be managed.

4.76 However, the experience of other countries suggests that alternative – and better models of economic growth, which not only increase wealth but improve living standards and tackle inequality – are achievable. Different choices can lead to both competitive and dynamic private sectors and growth which is more inclusive and balanced.
Chapter 5: Boosting Competitiveness and Reindustrialising Scotland

Chapter Summary

- Scotland is home to a number of highly successful companies. The country has key strengths in sectors such as food and drink, financial services, life sciences, energy, creative industries and tourism.
- However, there are ways in which Scotland’s business performance could be improved.
- Scotland’s business base needs expanding and independence will provide more powers to help future governments provide the right conditions and environment for firms to grow and innovate.
- Like the UK, the Scottish economy also needs to rebalance, this includes creating a greater role for manufacturing and securing more private investment.
- With independence, Scotland would be able to make full use of the range of economic levers to develop a coherent and ambitious strategy for promoting business growth and re-industrialising the economy.

Introduction

5.1 Scotland’s businesses are key drivers of economic growth and prosperity. They also play an essential role in creating high quality and sustainable employment opportunities.

5.2 Part of a government’s role is to create the conditions for a supportive, competitive and dynamic business environment.

5.3 Scotland has successful companies operating across sectors and markets. It is an attractive location for international investment and ranks highly on key league tables.

5.4 However, there is scope for improvement.

5.5 Scotland’s business base is relatively narrow, whilst evidence suggests that the country’s export base is concentrated in a small number of firms and sectors. Many other
countries attract higher levels of capital investment and their companies spend more on research and development.

5.6 The Scottish Government believes that addressing these issues, and the opportunity to build on Scotland’s natural and comparative advantages, can only be partially achieved under devolution.

5.7 Independence would provide much greater opportunities to promote business growth and to shape the long-term development of Scotland’s business base in a manner which delivers greater stability and supports re-industrialisation.

5.8 The exact policy choices undertaken post-independence will depend upon the priorities of the government of the day and the circumstances faced at a particular point in time.

5.9 However, the essential point is that such decisions, whatever the trade-offs involved, would be for the Scottish Government to decide upon, working in the interests of Scottish businesses.

5.10 This chapter discusses some of the key features of Scotland's business base and the policy levers open to future independent governments.

**Scotland’s Business Environment**

5.11 The structure of the economy and the nature of the business base are key determinants of economic performance.

5.12 Innovative, high value firms are more likely to export and to invest in research and development. This can enable them to become more competitive, grow more quickly and be more flexible to change.

5.13 A diverse business base - by firm size, industry, geography and ownership - improves the long-term health of an economy. It can complement a targeted strategy to excel in a small number of niche sectors.
5.14 A lesson of the recent crisis has been that diversification can also boost economic resilience.

5.15 While the structure of the Scottish economy and make-up of the business sector does not appear, at first glance, to be too dissimilar to the rest of the UK, Scotland lags international competitors in key areas.

5.16 In this chapter, four key priorities are considered –
- Diversifying Scotland’s Business Base;
- Rebalancing the Scottish Economy;
- Boosting Entrepreneurship and Business Growth; and
- Capturing the Opportunities from Scotland’s Comparative Economic Strengths.

Diversifying Scotland’s Business Base

5.17 A key challenge for Scotland is boosting and diversifying its business stock. Whilst the number of private sector enterprises in March 2013 was the highest since 2000, the number of businesses operating in Scotland (as a proportion of the population) is lower than in the UK.\(^{155}\) This has been a long-standing trend.

Table 5.1: Businesses per 10,000 Adults, Scotland and UK, 2013

<table>
<thead>
<tr>
<th>Country</th>
<th>Private Sector per 10,000 adults</th>
<th>Enterprise size (number of employees)</th>
<th>All sizes</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Small (0-49)</td>
<td>Med (50-249)</td>
</tr>
<tr>
<td>UK</td>
<td>939</td>
<td>6</td>
<td>1</td>
</tr>
<tr>
<td>Scotland</td>
<td>751</td>
<td>8</td>
<td>5</td>
</tr>
</tbody>
</table>


5.18 The vast majority of firms in Scotland are small, although large firms (those employing 250 people or more) account for the greatest share of private sector employment.

**Key Fact:** In 2013, 94% of firms in Scotland had fewer than 10 employees (compared to 96% for the UK).

Table 5.2: Distribution of Employment by Firm Size,\textsuperscript{156} 2010, across Select EU Countries

<table>
<thead>
<tr>
<th>Country</th>
<th>0 to 9 persons employed</th>
<th>10 to 19 persons employed</th>
<th>20 to 49 persons employed</th>
<th>50 to 249 persons employed</th>
<th>250+ persons employed</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td>22.0%</td>
<td>7.2%</td>
<td>9.1%</td>
<td>14.3%</td>
<td>47.4%</td>
</tr>
<tr>
<td>Scotland</td>
<td>19.3%</td>
<td>7.3%</td>
<td>8.0%</td>
<td>14.5%</td>
<td>50.9%</td>
</tr>
<tr>
<td>Germany</td>
<td>19.2%</td>
<td>10.9%</td>
<td>12.3%</td>
<td>20.5%</td>
<td>37.0%</td>
</tr>
<tr>
<td>Austria</td>
<td>25.4%</td>
<td>10.9%</td>
<td>13.0%</td>
<td>18.8%</td>
<td>31.8%</td>
</tr>
<tr>
<td>Finland</td>
<td>25.1%</td>
<td>9.1%</td>
<td>11.6%</td>
<td>16.8%</td>
<td>37.4%</td>
</tr>
<tr>
<td>Sweden</td>
<td>25.7%</td>
<td>9.4%</td>
<td>12.0%</td>
<td>18.1%</td>
<td>34.5%</td>
</tr>
<tr>
<td>Switzerland</td>
<td>18.0%</td>
<td>13.0%</td>
<td>14.6%</td>
<td>21.7%</td>
<td>32.6%</td>
</tr>
</tbody>
</table>

Source: IDBR, Eurostat

5.19 It is clear that Scotland has a gap in medium sized operations. Firms with 10 to 249 employees account for just 29.8% of total employment, compared to 43.7% in Germany (see Box 5.1).

5.20 Many of the firms operating in Scotland are UK-wide or overseas owned. In 2013, over 2,700 of the firms operating in Scotland (342,000 employees) had owners based elsewhere in the UK. The figures also show that there were over 2,100 foreign-owned companies employing around 302,000 people.

5.21 The Scottish Government believes that there are a number of explanations for these trends.

5.22 Firstly, merger and acquisition strategies have led to Scottish companies being taken-over by larger UK or international rivals (despite the consequences for market concentration or economic activity in Scotland).\textsuperscript{157} Over the years there has been a slow decline of headquarter functions in Scotland.\textsuperscript{158}

\textsuperscript{156} Data presented in this table is for 2010, as this is the latest available year for which comparison can be made across EU countries. Scottish and UK figures have been adjusted to ensure consistency, as far as possible, with Eurostat data.

\textsuperscript{157} See Fraser of Allander Quarterly Economic Commentaries from 2004 for discussion of ownership of companies in Scotland.

5.23 Secondly, the existence of ‘one-size-fits-all’ economic and business policies that reflect Scotland’s increasing emergence as an economy within the UK have acted as a barrier to local business growth.

5.24 Thirdly, the lack of autonomy to prioritise policies to help business invest, secure appropriate finance, tackle local challenges (such as distance from markets) and take advantage of local opportunities, has put Scotland at a disadvantage. Other countries have been able to use the full range of policy levers to support their economic geography, develop clusters and create more employment opportunities.

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**Box 5.1: The Success of Germany’s “Mittelstand” Sector**

The German Mittelstand sector refers to its small and medium sized enterprises (defined by the EU as having up to 250 employees or less than €50m turnover). These enterprises are the driving force of Germany’s economy, accounting for over 99% of German companies, and approximately 60% of German employment.\(^{159}\)

The sector is characterised by a high level of family-ownership: Over 95% of German firms are family owned. This is credited with giving the sector a long term outlook, focussing on:

- Sound financing models: Mittelstand companies are funded largely from their own equity and via bank loans;
- High levels of innovation: 54% of Mittelstand companies brought a product or process innovation to the market between 2008-10 compared to an EU average of 34%;
- Export based growth;
- Training and development: Four fifths of German trainees receive their training in the Mittelstand, contributing to Germany’s relatively low rate of youth unemployment; and
- Industrial Goods and Services: this sector accounts for 20% of all Mittelstand employees, whilst in the UK it accounts for 14.7% of SME employees.

These characteristics extend into larger companies that have graduated from SME, but the culture of the Mittelstand approach remains with close links between larger companies and medium sized companies through the supply chain.\(^{160}\)

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\(^{159}\) [http://www.bmwi.de/EN/Service/publications,did=506310.html](http://www.bmwi.de/EN/Service/publications,did=506310.html)

Rebalancing the Scottish Economy

5.25 There is a need to rebalance the Scottish economy. This will undoubtedly take time.

5.26 Part of any rebalancing requires a strengthened role for manufacturing – an area in which Scotland has a strong heritage.

**Key Fact:** Services are currently estimated to account for around 70% of output and 80% of employment.

5.27 As highlighted in Chapter 2, most advanced economies have experienced a decline in the relative size of manufacturing.

5.28 As Figure 5.1 highlights, in the UK this was particularly pronounced.

**Figure 5.1: Contribution of Manufacturing to GDP**

5.29 Some of this decline was undoubtedly the result of a growing services sector and international competition. However, it was also a consequence of macroeconomic policies and the lack of successive economic strategies that appreciated the merits of a strong manufacturing base –

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161 German data prior to 1990 refers to West Germany
“the relative decline in manufacturing has reflected deep-rooted structural problems. In particular there has been a chronic failure to invest in manufacturing, with the UK economy and investment instead being skewed towards short-term returns and the interests of the ‘City’”. 162

5.30 This had a number of consequences. Firstly, the loss of skilled jobs led to a sharp increase in unemployment in areas which were once manufacturing hubs. Scotland was particularly affected with limited investment or coherent plan to support communities through the adjustment. This in-turn led to a sharp rise in both income and regional inequalities which have become embedded in some areas.

5.31 Secondly, it helped fuel cuts to investment – see Figure 5.2. This has persisted for decades and is a significant drag on UK economic performance. 163

Figure 5.2: Gross Fixed Capital Formation (GFCF) as a percentage of GDP

5.32 In the UK, business investment – the largest component of overall investment – has been persistently low and fell as a share of GDP to 8.2% in 2011 (lower than the EU average of 10.9%). This trend has been attributed to a combination of factors, such as a culture of

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162 The De-industrial Revolution: The Rise and Fall of UK Manufacturing 1870-2010, page 2
short-termism in the UK economy, difficulties accessing finance, and a history of lower rates of corporate profits being re-invested in comparison to other advanced economies.\footnote{For example: Manufacturing in the UK: An economic analysis of the Sector, Department for Business Innovation and Skills, December 2010, Examining Sectoral Growth in the UK, Oxford Economics, 2010 and Investing for Prosperity, LSE Growth Commission, October 2012.}

5.33 A key priority for an independent Scotland should be to strengthen the role of manufacturing.

5.34 This would have a number of benefits including\footnote{The Future of Manufacturing: a new era of opportunity and challenge for the UK, BIS, October 2013, http://www.bis.gov.uk/foresight/our-work/projects/current-projects/future-of-manufacturing/reports-and-publications} –

- **Boosting high-value jobs** - studies show that average earnings in manufacturing tend to be higher than the non-manufacturing average,\footnote{For example data from the ONS Annual Survey of Household Earnings for 2012 shows that median manufacturing gross annual salaries were 25% higher than those in the service sector, and 19% higher than the average across all industries.} and lead to greater employment opportunities across the skills base;\footnote{For example US research indicates that 48% of manufacturing workers, but only 37% of non-manufacturing workers have no formal education beyond high school. Source: Why does manufacturing Matter? Which Manufacturing Matters?, Helper et al, 2012}

- **Promoting innovation** - although manufacturing firms account for only 12% of Scottish (onshore) output, they account for 66% of business R&D spending;

- **Addressing geographical disparities** - the decline in manufacturing has contributed to spatial imbalances across Scotland. However, increasing manufacturing activity in a local area can lead to spill-overs (e.g. from R&D) and help develop clusters of similar companies and local supply chains;

- **Boosting net trade** – the manufacturing sector generally has a higher propensity to export, for example around 62% of Scottish international exports are manufactured.\footnote{Global Connections Survey http://www.scotland.gov.uk/Resource/0041/00412570.pdf} It is therefore not surprising that the UK’s weak trade position has come alongside the decline in manufacturing.

5.35 It would also contribute to maximising the opportunities of the low carbon economy. Traditional manufacturing and engineering skills – for example supporting the offshore industry or shipbuilding – are highly transferable to areas such as the manufacture of
renewables technology or oil decommissioning – two areas in which Scotland has a clear competitive advantage.

Boosting Entrepreneurship and Business growth

5.36 Business start-ups are an important contributor to economic growth.

5.37 Between 1998 and 2010, start-up businesses (9 out of 10 employ less than five people at birth) were responsible for a third of overall job creation in the UK (around 870,000 jobs of an average 2.61 million created per year).  

5.38 Historically, Scotland has lower business start-up rates than the UK (although there appears to be some evidence that the gap has narrowed in recent years) – Figure 5.3.  

Figure 5.3: VAT/PAYE Registrations per 10,000 Resident Adults – Scotland & UK

![Graph showing VAT/PAYE Registrations per 10,000 Resident Adults - Scotland & UK](source: ONS)

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169 Danes, Bonner, Hart, Job Creation and Destruction in the UK, 2011

170 Unregistered businesses have also grown in Scotland – an increase of 40% between 2008-2012. Whilst this will undoubtedly reflect, to some extent, a pragmatic response to the recession, survey data suggests that this trend has been accompanied by an increase in entrepreneurial activity in Scotland.
5.39 The Global Entrepreneurship Monitor (GEM) assesses levels of entrepreneurial activity. The most recent figures for 2012 show a relative improvement in early-stage entrepreneurial activity rates over the last three years, with Scotland moving from the 4th to the 2nd quartile of the nations participating in GEM\textsuperscript{171} – Figure 5.4.

**Figure 5.4: Total Early State Entrepreneurial Activity Rates, 2012**

5.40 As new sectors and businesses emerge, strong domestic supply chains – and not just final demand – is key. Supply chains are where sectors source their inputs, which they then use to produce products and services. Being part of a strong supply chain, servicing both domestic and overseas production processes, can be an important part of the ecosystem of the Scottish economy.

5.41 This is particularly important in the current climate, where many firms are re-examining their supply chains and are re-focussing on low-risk locations and the benefits of flexibility and collaboration.\textsuperscript{172}

\textsuperscript{171} GEM 2012 Report http://www.gemconsortium.org/docs/download/2812

5.42 The Scottish Input-Output model shows that the manufacturing sector in Scotland is particularly integrated into global supply chains and sources a large proportion of its inputs from suppliers located in other countries.\textsuperscript{173} It is also the sector that provides the largest contribution to the inputs of other sectors within Scotland. The fact that certain Scottish supply chains are broken and have high degrees of import penetration reflect a wider structural challenge in the Scottish economy and lack of competitiveness at various stages in the production process.

Capturing the Opportunities from Scotland’s Comparative Economic Strengths

5.43 Whilst it is important to support the development of a diverse business base, countries of Scotland’s size find an advantage in prioritising part of their efforts to develop international comparative advantages in a select number of sectors.

5.44 The New Economic Geography literature\textsuperscript{174} discusses how clusters can develop in particular localities for reasons such as endowments, institutions and technology. Through time, these clusters (or agglomeration economies) can develop and grow with positive externalities (such as labour market pooling and knowledge sharing) leading to a virtuous cycle of development.

5.45 It is not about ‘picking-winners’ but more about deliberate choices as to where countries will be competitive against other locations, and what mix of policies best suits the country.

5.46 The exposure to external competition means that such a strategy needs to be dynamic and adaptable to a changing external environment. This makes it well suited to smaller countries with more flexible institutions and structures.

5.47 A growth sectors approach has been adopted by successive administrations in Scotland. Since 2007, the Scottish Government has focussed upon –

- The Creative Industries;
- Energy – in particular, Oil and Gas, and Renewables;

\textsuperscript{173} \url{http://www.scotland.gov.uk/Topics/Statistics/Browse/Economy/Input-Output}

- Financial and Business Services;
- Food and Drink (including agriculture and Fisheries);
- Life Sciences;
- Sustainable Tourism; and,
- Universities.

5.48 Under independence, future Scottish governments will have the opportunity to draw on the full range of economic levers in order to support the development of Scotland’s growth sectors. For example, with independence it would be possible to maximise the linkages across policy actions - including tax incentives, actions to support innovation and investment, and regulation - to create a cohesive and supportive framework to enable Scotland’s growth sectors to reach their full potential.

**Opportunities to Boost Competitiveness and Re-industrialise Scotland under Independence**

5.49 The discussion above has highlighted key strengths of the business sector in Scotland, but also identified a number of areas for improvement.

5.50 Successive Scottish – and UK – governments have attempted to tackle these issues. Box 5.2 provides a summary of some key initiatives of the current Scottish Government.

**Box 5.2: Scottish Government Actions to deliver a Supportive Business Environment**

Within the devolved powers available, the Scottish Government has pursued a range of actions to help deliver a supportive business environment –

- Maintaining Enterprise Agencies to promote business growth;
- Cutting, or eliminating, business rates, via the Small Business Bonus Scheme for tens of thousands of business properties;
- Delivering via Business Gateway a first point of contact for business support;
- Attracting major international companies to Scotland;
- Introducing the Regulatory Reform (Scotland) Bill to deliver better regulation;
- Establishing a Scottish Investment Bank to invest in businesses; and
- Investing in vital infrastructure – including transport and digital communications.
5.51 However, as highlighted in Chapter 4, Scottish governments do not have full flexibility to establish policies that reflect the unique challenges and opportunities in the Scottish business sector.

5.52 There are a number of avenues through which independence could lead to better outcomes. Clearly it can allow for greater policy discretion to promote business development.

5.53 It has also been argued that there could be a “psychological ‘independence’ stimulus” that acts as a boost to business growth.\textsuperscript{175} For example, a number of economists believe that independence could strengthen Scotland’s national economic self-confidence.\textsuperscript{176}

5.54 At the same time, the experience of other countries of Scotland’s size suggest that a clearer – and more shared – vision for industrial and business strategy is possible.

5.55 As an independent nation, Scotland would be able to use its size to its advantage in order to engender collaboration and cooperation. A clear objective would be to bring together business, academia, government and trade unions in the common interest, something that can arguably be more difficult in larger countries for practical reasons.

5.56 Such moves could be as radical, or as restrained, as future elected governments of Scotland wished. For example, a number of countries promote employee representation on the executive boards of companies,\textsuperscript{177} whilst in others, pay awards and labour market structural reforms take on a much more collegiate and national approach.

5.57 Independence would also allow Scotland to forge its own policies aimed at retaining headquarter functions, including the opportunity to develop business hubs in areas of comparative advantage.

5.58 The remainder of the chapter outlines some of the policy opportunities available.

\textsuperscript{175} The Impact of Greater Autonomy on the Growth of the Scottish Economy, McGregor and Swales, Chapter 6 of Scotland’s Future: The Economics of Constitutional change, Andrew Goudie, 2013


\textsuperscript{177} See: http://www.eurofound.europa.eu/temire/GERMANY/CODETERMINATION-DE.htm
Taxation

5.59 The ability to use new tax powers in a manner which reflected Scotland’s unique circumstances could be a major policy opportunity post-independence.

5.60 There are a number of facets to this. Firstly, designing a more efficient tax system – built upon the principles set out by the Fiscal Commission Working Group - could provide a major competitive edge for businesses in Scotland.  

5.61 Secondly, tax autonomy would provide the opportunity to apply a range of policies, including business taxes (e.g. corporation tax), taxes on employment (e.g. national insurance) and taxes on consumption (e.g. fuel duty) in a manner which reflected Scotland’s economy and business base – Box 5.3.

5.62 Of course, in providing any tax reliefs and allowances, the government would need to balance the expected benefits of a particular policy with the overall objectives for the tax system as a whole. This trade off could be in terms of increased investment, jobs, innovation, or output versus factors such as keeping a simple and transparent system with minimal administrative and compliance burden.

5.63 While there will indeed be trades-offs, the Fiscal Commission Working Group highlighted that a simple tax regime does not imply there should be no exemptions and reliefs. Rather that any such policy choices should be clearly targeted, transparent, supported by analytical evidence and reviewed regularly to ensure that they are achieving their desired outcomes.

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Box 5.3: Case Study: Corporation Tax

As an example of the type of policy choices that an independent Scotland could make, the Scottish Government has cited using a modest cut in corporation tax to help boost output and employment.

Under the current framework, few business taxes are varied at a regional level.

To help counterbalance the pull of London and the South East, the Scottish Government has argued that the use of a targeted tax incentive will not only give Scottish companies a competitive advantage (and mitigate any natural geographical disadvantage they may face) but will also help attract international investment.

As an illustration, in 2011, the Scottish Government modelled the potential impact of a reduction in corporation tax broadly equivalent to a cut in the headline rate of 3 percentage points. The results showed this has the potential to increase output by around 1.4% and boost employment by approximately 27,000 jobs. It can also help rebalance the economy by raising investment – an increase of 1.9%. These impacts are presented here after 20 years, but the modelling shows that many of the benefits could occur shortly after the tax announcement and lead to a rise in tax revenues in the long-term.

A report by the Scottish Parliament Information Centre (SPICe) concluded that “most plausible scenarios resulting from a cut in corporation tax are likely to expand the economy, create jobs and increase investment”.

Clearly this is just one policy an independent Scotland could choose and a range of options are possible. For example, accompanying supply side or employment policies could be set to complement such a change.

5.64 Most policy discussions concerning taxation, particularly in terms of competitiveness, focus upon the tax rate. However, in reality the range of tax policy options are more nuanced (and, depending upon the circumstance, arguably more powerful).

5.65 For example, the base upon which taxes are levied is highly important. Allowances from certain taxes may be provided if such allowances support capital or R&D investment. By reducing the tax bill this can incentivise activities and behaviours that lead to benefits for the wider economy.

5.66 Analysis assessing the competitiveness of corporation tax rates,\textsuperscript{181} including available capital allowances, ranked the UK 22\textsuperscript{nd} in terms of effective average tax rates and 31\textsuperscript{st} out of 33 OECD countries for effective marginal tax rates in 2012. The same report highlighted that, in 2012, the UK’s poor ranking was “…again mostly due to the lack of generosity of allowances for capital expenditure: amongst the 33 OECD countries, only Chile has less generous allowance.” This was “a particular concern given the last part of the [UK] government’s aim, to protect manufacturing industries.”

5.67 A complementary or alternative approach would therefore be to raise a slightly higher amount of revenue from the tax rate to fund more attractive incentives for investment in the tax base. For example, more generous capital allowances.

5.68 In theory, such allowances could also be used to incentivise activity which contributes towards the government’s wider economic objectives such as increasing investment and support for manufacturing. It is also possible to vary taxation – subject to State Aid rules – to support certain types of firms (e.g. smaller firms) or key sectors that make a disproportionate contribution to the local economy\textsuperscript{182} (Box 5.4).

\begin{footnotesize}
\begin{itemize}
\item Box 5.4: Case Study: Tax Policy Approaches to Support SMEs

Across the OECD, countries use a range of tax policies to support small and medium-sized enterprises (SMEs).\textsuperscript{183}

\textbf{Tax rates and allowances}

Tax incentives are typically used to support SMEs and to provide a competitive advantage relative to larger firms. The UK is however, in the process of abolishing the smaller companies corporation tax rate (at the same time as reducing the headline rate). Soon all companies will be the same rate regardless of size – this is unusual.

\end{itemize}
\end{footnotesize}

\textsuperscript{181} CBT Corporate Tax Ranking 2012, Bilicka and Devereux, June 2012 http://www.sbs.ox.ac.uk/sites/default/files/Business_Taxation/Docs/Publications/Reports/cbt-tax-ranking-2012.pdf. The study also highlighted that even when the planned changes, at the time of study, in corporate tax rates are introduced by 2015 the UKs effective marginal tax rate would still only be ranked 32nd and the effective average tax rate ranked 16\textsuperscript{th} out of 33 OECD countries in 2015. Since this study the UK Government announced at Budget 2013 that the headline rate of Corporation Tax would be reduced to 20% from 1 April 2015.

\textsuperscript{182} Any target actions would have to be developed in accordance with European Union State Aid rules, and, where required, the Scottish Government would give notification to the European Commission.

\textsuperscript{183} Based on comparisons of approaches to supporting SMEs produced by the OECD in October 2009: http://www.oecd-ilibrary.org/taxation/taxation-of-smes_9789264024748-en.
Examples to encourage start-ups and early stage firms include allowing certain small business losses to be deducted against other taxable income.

Many countries offer more generous allowances for expenses, depreciation and tax credits for investment for SMEs. In Germany, for example, small businesses are given additional depreciation allowances relative to standard rates.

Some countries – such as Belgium – offer incentives to hire workers. If the workforce subsequently falls back, these allowances can be reclaimed by the tax authority.

**Financing / equity support measures**

To encourage investment many countries also offer concessions to those who invest in SMEs –

- Canada, the US and Japan all offer reductions in capital gains taxes (CGT) for shareholders disposing of SME stock.
- Some countries specifically target venture capital investments. Australia and Ireland effectively exempt all venture capital investments from CGT.

**Simplification / reducing compliance burden**

Tax compliance can be costly, so many countries offer compliance concessions for SMEs.

- One common approach – including in the UK – is a VAT threshold, where firms earning below a certain level are exempt from registering. Countries such as Ireland have a range of thresholds depending on business type.
- Other simplifications include allowing VAT to be calculated on a cash basis for small firms (Australia and Ireland) or by reducing the required frequency of VAT returns (Austria, Denmark and Norway); and exempting small businesses from preparing full annual accounts (Austria, Norway and Sweden) for tax purposes or by reducing the frequency of tax filing.

5.69 The sectors toward which particular tax policies are targeted may legitimately differ between Scotland and the UK, depending upon respective economic priorities and the relative importance of sectors to each particular economy.

5.70 For example, the decision by the UK Chancellor in 2011 to significantly increase the tax burden on the oil and gas sector had a much greater impact on Scotland’s economy than the UK as a whole.
5.71 With access to all fiscal levers following independence, future Scottish Governments could provide targeted support for key sectors – recent examples discussed in Scotland include the video games industry, tourism and creative industries, where countries such as France and Ireland have introduced specific measures.

5.72 Any such tax measures need to be balanced against the need to have both a simple and transparent tax system alongside stable and sustainable public finances. However, future governments in an independent Scotland could consider similar methods of supporting key sectors in the country as part of a wider economic strategy.

5.73 It is not just traditional ‘business taxes’ or taxes on capital income that can have an impact. For example, both employees and employers typically make social security contributions.\(^{184}\)

5.74 Changes in employer contributions influence the cost of employment and can therefore impact on the demand for workers – Box 5.5.

**Box 5.5: Case Study: Tax Policy to Support Employment Demand – UK Relief on Employer National Insurance Contributions**

In the June 2010 Budget, the UK Government announced the ‘Regional Employer National Insurance Contributions Holiday for New Businesses’.

The scheme allowed businesses which started up between 22 June 2010 and 5 September 2013 to receive a deduction of up to £5,000 from employer NICs for each of the first ten employees they took on.

It had been estimated that during the three years of the scheme, 400,000 new businesses in the UK would benefit.\(^{185}\) However by December 2012 (over two years into the scheme) just 20,365 firms had successfully applied, with 3,125 based in Scotland.\(^{186}\)

Although the scheme was designed to help create new businesses and support start-ups, the scheme was not well targeted or promoted. In addition whilst it provided generous support to start-ups hiring up to ten employees no additional support was provided for new businesses unable to hire or for established small businesses looking to hire new workers.


\(^{186}\) http://www.hmrc.gov.uk/statistics/nics-hol.htm
The principle behind such a scheme – using taxation to support employment creation – is however important. Under independence, Scotland could choose to adopt an improved scheme, something more nuanced to the Scottish small business base and/or deliver such a scheme more efficiently.

5.75 In summary, Scotland’s business structure differs from the rest of the UK. The design of a one-size-fits-all tax system for the UK in terms of its support and incentives for start-ups and business growth is not optimal.

5.76 Moreover, many of the challenges that Scotland faces, for example in diversifying the economy and encouraging business development, have been dealt with more successfully in other countries. This suggests that there is scope for more local policies and priorities to lead to better outcomes.

5.77 Finally, with responsibility for the entirety of taxation, and related policy levers such as employability, welfare and industrial policy, Scotland would be able to consider the appropriateness of all business related levers together and to exploit synergies in a manner not currently possible.

**Competition and Regulation Policy**

5.78 Regulation protects consumers, businesses and the environment. In a modern mixed economy, the aim is to be transparent, proportionate, consistent, accountable and targeted.

5.79 At the same time, competition is important not just for consumers (through lower prices and greater choice) but also for businesses. It encourages efficiencies and boosts incentives to invest and innovate.

5.80 Whilst a significant amount of policy is now set at the EU level, it is important to have a coherent and joined-up approach to competition and regulation policy between policies that are retained locally and the implementation of EU laws and Directives.
The Scottish Government has published a detailed paper on regulation and competition policy for an independent Scotland. It makes the case that with the full set of levers future Scottish governments could –

- Deliver a streamlined and efficient regulatory model appropriate to Scotland’s economy. A combined economic regulator, responsible for regulation of water, energy, rail, postal services and telecommunications, could deploy resources more effectively and flexibly than is currently the case, and
- Pursue an approach to competition policy which better reflected the structure of Scottish markets and firms.

**Box 5.6: Case Study: Economic Regulation in the Netherlands**

The Netherlands introduced a fully combined consumer, competition and regulatory body in April 2013.

The Netherlands Authority for Consumers and Markets (ACM) is a merged authority from the Netherlands Consumer Authority, the Independent Post and Telecommunications Authority (OPTA), and the Netherlands Competition Authority (NMA).

It aims to ensure that markets work and protect consumer interests, focussing on three themes: consumer protection, industry-specific regulation, and competition oversight.

The Dutch Government has stated that the key aims of such a policy are increased efficiency and effectiveness of competition oversight, market regulation and cost savings. The rationale is that a combined regulator is better able to anticipate market developments, make better use of cross discipline expertise and to respond in a flexible and integrated manner.

Alongside this, a successful economy is underpinned by a strong consumer protection and representation framework.

The Scottish Government believes that the existing UK approach is fragmented and confusing. The Scottish Government has set out its vision for how an independent Scotland could develop a consumer landscape that is simplified and more integrated.

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187 http://www.scotland.gov.uk/Publications/2013/02/1911
5.84 Such a landscape could be implemented through a single consumer body to oversee the provision of high quality, efficient consumer advice and protection; it would be able to take into account Scottish specific issues (that, arguably, the current fragmented UK arrangements have often failed to do), such as parcel delivery charges in rural areas.

5.85 This would also create an opportunity for a unified consumer body to be combined with a competition authority, potentially bringing even closer alignment between market arrangements and consumer interests.

**Box 5.7: Case Study: Consumer Protection and Competition in the Republic of Ireland**

In recent years, a number of EU member states have integrated their competition authorities with consumer protection agencies.

In Denmark, the Danish Competition Authority and the Danish Consumer Agency merged into the Danish Competition and Consumer Authority in 2010; whilst in Finland the new Finnish Competition and Consumer Authority began operating at the start of 2013.

However, these bodies do not include all elements of consumer protection, such as advocacy, education and advice.

In contrast, Ireland is planning to pursue a much higher level of integration with the proposed merger of its National Consumer Agency (NCA) and the Irish Competition Authority.

It is planned that the merged agency will perform the same functions as the previously separate bodies, but in a more integrated way. This means a single body will be responsible for competition, as well as consumer enforcement, education, advice and advocacy.

5.86 Taken together, the Scottish Government believes that these proposals for regulation, competition policy and consumer protection have the potential to significantly improve the business environment in Scotland.

**Supporting Investment**

5.87 Investment is a driver of economic growth over the medium term, whether by business or government, and whether in new or existing assets.
5.88 As highlighted earlier in the chapter, levels of investment in the UK have been consistently lower than that undertaken by competitors.

**Key Fact:** IMF data shows that the UK ranked 30 out of 35 advanced economies for investment as a percentage of GDP in 2012.

5.89 While governments can undertake investment directly, facilitating private investment – e.g. through access to finance – is a key factor in business growth and development. This is especially important for smaller firms who are often more reliant on the financial sector and have fewer alternative sources of own-source finance.

5.90 As a private capital market, businesses and individuals in an independent Scotland would retain access to existing market centres in the UK and globally. For example, the London Stock Exchange lists around 2,500 companies from over 70 jurisdictions.\(^\text{189}\)

5.91 Scotland has already demonstrated the ability to develop innovative approaches in the areas it currently has responsibility. For example, the Scottish Co-investment Fund – which addresses early stage equity gaps and has helped develop the business angel investment market – has been cited as an exemplar by the European Commission. It has been replicated in New Zealand, Sweden, Canada and England and is the basis for the European Investment Fund’s (EIF) Angel Co-investment Fund, which the EIF intends to roll out across Europe.

**Box 5.8: Case Study: Access to Finance for SMEs**

Lack of affordable finance is a well-known challenge, particularly at different stages in the growth cycle of firms.

Under the current framework, a number of government supported schemes are administered in Scotland. However, the system is complex with the UK Government also operating its own schemes. The UK Government retains ultimate responsibility for the market for finance.

The evidence also suggests a number of differences between Scotland and the UK in accessing finance. For example, the 2012 Small Business Survey found that:

- Whilst more SMEs in Scotland sought finance in 2012 than in the UK, they found it

\(^{189}\) Source: http://uk.advfn.com/exchanges/LSE
slightly more difficult to obtain finance; and,

- Scottish SMEs had particular difficulty in obtaining bank loan finance compared to UK SMEs;

In general, some SMEs – particularly exporters or high growth potential firms – appear to face quite tough constraints in obtaining the financing required.

Across the UK, a range of schemes are provided. For example, the Funding for Lending scheme (operated jointly with the Bank of England) aims to increase lending by lowering interest rates and easing credit while the Enterprise Finance Guarantee (EFG) scheme provides government-backed guarantees to fill a gap in the market for business loans.\footnote{See http://www.bankofengland.co.uk/markets/Pages/FLS/default.aspx and https://www.gov.uk/understanding-the-enterprise-finance-guarantee for more information.} A number of other schemes such as the Business Finance Partnership (BFP) and various ‘angel’ and equity funds provide alternative sources of funding to bank lending.

As these schemes are provided at the UK level, it can often be difficult to gain a perspective on performance and impact in Scotland. This is far from ideal and limits the ability for policymakers, lenders and businesses to make evidence based assessments and to respond accordingly.

There is also some evidence that UK Government’s policies are not working effectively, with net lending by participants falling since the start of the Lending for Funding scheme, particularly in relation to lending to businesses.\footnote{http://www.bankofengland.co.uk/markets/Pages/FLS/data.aspx} Since the start of 2012, net lending flows to individuals have typically been positive, whereas net lending to businesses of all sizes has mostly been negative. This is arguably the opposite of what would be a sustainable pattern for an economy seeking to move from consumption to investment-led growth.

Under independence, future Scottish governments would have the powers to put in place access to finance schemes that reflected distinct conditions in the Scottish marketplace. It would also be able to operate them flexibly, responding to changes in the economy or business demand.

A possible, more radical, policy initiative post-independence could be the creation of an active business bank that could borrow directly from the market and pass on the benefits to Scottish growth businesses.
5.92 Alongside private sector investment, enabling infrastructure (both physical and increasingly in areas such as digital connectivity) is key to a supportive and dynamic business environment.

5.93 A key determinant of business development, and overall productivity, is the quality of infrastructure. The role of policy is to ensure that, where affordable, essential infrastructure investment that would not be undertaken in the absence of public intervention is provided.

5.94 Under the current framework, Scotland is constrained in how it can prioritise such investment, both in terms of scale and timing.

5.95 For example, the fragmentation of mobile and broadband initiatives at a UK level, and the reserved nature of telecoms policy and regulation, prevents Scotland from realising the full economic benefits that could be achieved through an integrated approach to digital connectivity (see Box 5.9).

### Box 5.9: Case Study: Supporting World-Class Digital Ambitions

The Scottish Government has an ambition to deliver a world-class digital vision, which will support any device, anywhere, anytime connectivity across Scotland by 2020.

Under the current framework many of the levers required to support this ambition are reserved.

For example, the UK Government is currently delivering a number of programmes including a £530m rural broadband fund, a £150m super connected cities fund, a £150m mobile infrastructure fund and £250m to deliver superfast broadband to 95% of the UK population by 2017. All of these projects are being administered separately, have different aims and objectives and are not yet fully aligned. The Scottish Government believes that the overall investment made by the UK Government is not being utilised to maximum impact.

Under independence, Scotland would have the opportunity to better align policy, taxation and regulation to deliver a coherent overall approach. The design of broadband and mobile initiatives could be improved and specifically targeted at the needs of Scotland. The Scottish Government believes that an improved outcome could be achieved for the same level of public investment.

Scotland could aim to learn from successful approaches in other countries such as the
regulatory and policy regimes of European leaders like Sweden, who introduced a 99% coverage obligation as part of their 3G and 4G spectrum auctions, delivering extensive coverage in rural and remote areas.

Future wireless and mobile technologies will also play a key role and have the potential to provide high speed broadband to rural areas. Forthcoming spectrum releases, such as the 700 MHz band, could potentially offer significant benefits for mobile broadband coverage, particularly in rural Scotland. Independence would enable a future Scottish Government to offer new spectrum licenses that delivered maximum availability of mobile services throughout Scotland as a whole.

5.96 Finally, the Scottish Government has significant autonomy over how capital is spent on devolved issues. However, the overall envelope and the timing of such spending is heavily constrained. This can be especially important for business, particularly where it relates to connectivity.

5.97 The Scotland Act 2012 will provide new limited borrowing powers. However, not only will the scale be constrained at around £296 million per annum for capital purposes (10% of the capital budget) and up to £200 million for smoothing fluctuations in tax receipts relative to forecasts. As the Act has limits on borrowing, it cannot be used flexibly, for example to prioritise borrowing at particular points in time.

5.98 Independence would provide full autonomy to manage such borrowing in a responsible manner, but also to prioritise support for infrastructure in a way which was in the long-term interests of the Scottish economy.

Conclusion

5.99 Scotland’s business structure differs from the rest of the UK. The design of a one-size-fits-all tax system for the UK in terms of its support and incentives for start-ups and business growth may not always be optimal.

5.100 Moreover, many of the challenges that Scotland faces, for example in diversifying the economy and encouraging business development, have been dealt with more successfully in other countries. In an increasingly global economy where every competitive edge is vital, this
suggests that there is scope for more Scottish specific policies and priorities to lead to better outcomes.

5.101 Independence would provide the Government of Scotland with significantly enhanced powers to boost the competitiveness of its business base and rebalance the structure and composition of the economy. The Government of an independent Scotland may choose to use these additional economic levers in a number of ways.

5.102 For example it may wish to –

- Establish a tax regime targeted to the needs of Scottish business and which promoted growth, investment, entrepreneurship and innovation;
- Use carefully targeted tax measures, such as a reduction in corporation tax, to counterbalance the pull of London and the South East;
- Prioritise the timing and scope of investment in Scotland’s business enabling infrastructure;
- Use employer taxes – such as National Insurance reliefs – to support employment and encourage more sectors/companies to recruit staff;
- Put in place competition and regulatory policies that reflect the unique circumstances of the local business community and which take advantage of Scotland’s size;
- Prioritise efforts to establish a competitive market for business finance which is complemented by government initiatives to target gaps for Scottish firms;
- Establish an industrial strategy which aims to rebalance the economy and diversify Scotland’s industrial base - promoting manufacturing and focussing on new opportunities in key industrial areas;
- Consider the appropriate role for core national infrastructure – such as postal services, transport and energy – given Scotland's size and geography; and,
- Integrate business and industrial strategies, with trade, foreign policy and international engagement to take advantage of Scotland’s new place on the global stage and promote international investment and trade.

5.103 A key part of supporting businesses and boosting competitiveness is through innovation, this is discussed in the next chapter.
Chapter 6: An Economy Wide Focus on Increasing Innovation

Chapter Summary

- Over the long-run, improving productivity is the key driver of faster sustainable growth.
- Innovation is central to this. Innovative economies are also more resilient and adaptable to change.
- Scotland has an enviable history of innovation stretching back to the industrial revolution.
- Today however, Scotland’s performance is mixed. For example, whilst Scotland has an enviable record of research and development (R&D) in higher education, business investment in R&D lags behind.
- Under independence, future Scottish governments would have much more opportunity to establish a coherent framework for supporting innovation across the economy.
- An innovation strategy could be targeted specifically at key areas of strength and weakness in Scotland.
- In addition, independence would provide access to specific policy levers which could potentially be used – as part of the overall policy framework – to support and encourage innovation.
- There would be the potential to use either direct financing levers (such as the provision of loans and guarantees, the use of competitive grants, innovation vouchers, and the establishment of an Innovation Agency or Institute) or indirect levers (such as tax-based incentives).

Introduction

6.1 Innovation is a broad concept. It encompasses the development of new processes, products, services and business models, which create economic opportunity.

6.2 Innovation is a key driver of productivity and long-term sustainable growth.\(^{192}\) It also has a significant bearing on an economy’s ability to respond to changing circumstances with innovative economies more likely to bounce-back from upheaval than less innovative ones.

\(^{192}\) Aghion and Howitt, 2009, “The Economics of Growth Theory”, provides an overview of the economic theory of growth and the importance of technological progress as the main driver. More
6.3 Moreover, in an increasingly competitive global economy, innovation is key to success in international markets. It is also especially vital for a developed economy such as Scotland which is less able to compete on cost alone with emerging economies.

6.4 The evidence suggests that successful knowledge building stems from an important partnership between the private and public sector. Government policy, through the tax system, patents and the competitiveness of markets, creates the conditions for private sector innovation to flourish.

6.5 Economic policy also has an important role in shaping accompanying institutional arrangements and social conventions. In particular, governments have a responsibility to support and drive innovation themselves. As highlighted in the “Entrepreneurial State” work “…successful economies result from government doing more than just creating the right conditions for growth. Instead, government has a key role to play in developing new technologies whose potential is not yet understood by the business community.”

6.6 Scotland has a relatively strong base of innovation to build on. It has a tradition of commitment to research and science, a highly-skilled workforce and world renowned universities.

6.7 However, on current international comparisons, Scotland and the UK lag behind key competitors. For example, as a proportion of GDP, Denmark and Finland spend nearly double on R&D than Scotland.

6.8 Challenges include how to stimulate innovation amongst businesses and how to improve levels of commercialisation of academic research and innovation by the public sector. Scotland’s business investment in R&D is also relatively concentrated in a small number of firms.

6.9 This is not simply a matter of spending more. In a country of Scotland’s size it is also about ensuring a coherent and focused approach on strategically important economic areas and establishing a culture of innovation and knowledge exchange along with demonstrating a clear determination to succeed.

recently, NESTA’s Plan I from 2012 underlines how “decades of research have shown that innovation is the most important driver of long term productivity and prosperity”.

193 The Entrepreneurial State, Mariana Mazzucato,
http://www.demos.co.uk/publications/theentrepreneurialstate
Scotland’s Innovation Environment

6.10 In this section three key areas are considered.

- Overall Levels of Innovation;
- Investment in Research and Development; and
- Innovation Mix.

Overall Levels of Innovation

6.11 Measuring innovation is notoriously difficult. Often the focus is therefore on the determinants of innovation, such as investment in R&D.

Figure 6.1: Percentage of Enterprises Classified as Innovation Active, 2008-2010

6.12 The 2011 UK Innovation Survey shows that relative to the UK average, Scotland has a smaller proportion of businesses that are ‘innovation active’ (33%) compared to the UK (37%).

195 http://webarchive.nationalarchives.gov.uk/+/http://www.bis.gov.uk/policies/science/science-innovation-analysis/cis An innovation active enterprise is defined as one which has introduced a new or significantly improved product (good or service) or process; engaged in innovation projects not yet complete; or has introduced significantly improved forms of organisation, business structures or practices and marketing concepts or strategies.
The survey also showed that Scotland has persistently performed below the UK average for innovation activity over a number of years. Within the data, analysis reveals that businesses in Scotland have a greater focus on innovation to reduce costs with less emphasis on increasing the range of goods and services. As a result of this, levels of business investment in innovation are lower in Scotland but Scottish firms spend a greater proportion of total expenditure on machinery, equipment and software.\footnote{Scottish Enterprise analysis of UK Innovation Survey 2011}

**Key Fact:** In 2008-10 18.1% of enterprises in Scotland innovated a product or process, compared to 21.6% of enterprises in the UK as a whole.

### Investment in Research and Development

A key driver of innovation is research and development (R&D). Scotland and the UK lag behind a number of key competitors on this indicator.

**Figure 6.2: Total Expenditure on R&D as a Percentage of GDP, 2001 and 2011**

<table>
<thead>
<tr>
<th>Country</th>
<th>2001 or First Available Year</th>
<th>2011 or Latest Available Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chile</td>
<td>1.0</td>
<td>1.5</td>
</tr>
<tr>
<td>Mexico</td>
<td>2.0</td>
<td>2.5</td>
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<tr>
<td>Greece</td>
<td>1.5</td>
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<tr>
<td>Poland</td>
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<tr>
<td>Turkey</td>
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<td>Italy</td>
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<td>Spain</td>
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<td>Portugal</td>
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<td>Scotland</td>
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<td>Norway</td>
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<td>Canada</td>
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<td>Czech Republic</td>
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<td>New Zealand</td>
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<td>Hungary</td>
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<tr>
<td>Netherlands</td>
<td>1.0</td>
<td>1.5</td>
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<tr>
<td>EU28</td>
<td>1.5</td>
<td>2.0</td>
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<tr>
<td>Belgium</td>
<td>1.0</td>
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<tr>
<td>Austria</td>
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<td>1.0</td>
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<tr>
<td>France</td>
<td>0.5</td>
<td>1.0</td>
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<tr>
<td>OECD</td>
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<td>Estonia</td>
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<td>Slovenia</td>
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<td>Austria</td>
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<td>USA</td>
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<td>Switzerland</td>
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<tr>
<td>Korea</td>
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<tr>
<td>Israel</td>
<td>0.5</td>
<td>1.0</td>
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</tbody>
</table>

Source: OECD, ONS and Scottish Government

6.15 Such investment in science, technology and human capital, has coincided with many of the same group of countries also experiencing relatively strong export growth in recent years.
6.16 Multi-National Corporations (MNCs) have an important role in the innovation system. As well as the relative size of their investments – which often out-scale domestic investment potential – MNCs can also draw on international networks, expertise and capital. A key challenge however, is ensuring that the benefits from such investments spill-over into the wider local economy.

Innovation Mix

6.17 In August 2012, a review of Scottish research and innovation policy concluded\(^{197}\) -

“Scotland’s innovation performance can be summed up as a form of dichotomy with a relatively strong higher education and public research performance contrasting with business innovation and entrepreneurial activity lagging far behind other small northern European countries.”

Scotland’s Higher Education Research and Development (HERD) is world class. In 2011, Scotland’s HERD expenditure as a percentage of GDP ranked top of the 12 countries and regions of the UK. Scotland was third in the OECD.\(^{198}\)

The weakness between Scotland and international competitors reflects lower levels of Business Expenditure on R&D (BERD). This is in part due to industrial structure with the decline of manufacturing acting as a barrier to innovation (around 66% of BERD in Scotland in 2011 was in manufacturing\(^{199}\)).

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\(^{198}\) Gross Expenditure on Research and Development 2011, ONS

6.20 The value of BERD undertaken in Scotland in 2011 (at £689 million) was only 4.0% of the UK total – below a per capita share.

6.21 There has however, been a relative improvement in Scotland’s BERD activity in recent years (an increase of 15.7% in real terms between 2007 and 2011 compared to 1.2% in the UK).\textsuperscript{200}

6.22 It is not unsurprising for the majority of BERD activity to be undertaken by larger firms.\textsuperscript{201} This is particularly the case in Scotland with the top 5 firms accounting for over a fifth of Scottish R&D employment in 2011.

6.23 While supporting investment in large firms is therefore important, establishing a culture of innovation and its commercialisation amongst SMEs is also vital - particularly if innovation is to take hold across the business base.

\textsuperscript{200} R&D expenditure in Scotland can fluctuate significantly year on year, especially given that R&D expenditure is concentrated in a small number of big companies. In 2011, the top 5 firms (out of 1995) accounted for almost a third of Scottish R&D expenditure. This is a sizeable share of total R&D expenditure, however it represents a fall in the dominance of the top firms since 2001. In 2001, the top 5 firms accounted for just over a half of R&D expenditure.” http://www.scotland.gov.uk/Resource/0041/00411186.pdf

\textsuperscript{201} Business R&D, Innovation and Economic Growth: An Evidence-Based Synthesis of the Policy Issues, New Zealand Ministry of Economic, May 2006
Innovation Policy Approaches in an Independent Scotland

6.24 Within the limited powers available, the Scottish Government is pursuing a range of actions to support innovation (see Box 6.1).

<table>
<thead>
<tr>
<th>Box 6.1: Scottish Government Actions to Support Innovation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recent initiatives by the Scottish Government to support innovation activity targeted to Scotland include –</td>
</tr>
<tr>
<td>• Supporting R&amp;D and innovation in universities;</td>
</tr>
<tr>
<td>• Providing a minimum of £45 million annual expenditure in each year of the 2012-15 Spending Review to provide support for innovation and R&amp;D through SMART: SCOTLAND;</td>
</tr>
<tr>
<td>• Providing innovation advice and grant support for businesses;</td>
</tr>
<tr>
<td>• Supporting commercialisation through a range of initiatives that seek to match industry and academia; and</td>
</tr>
<tr>
<td>• A Proof of Concept (PoCP) programme to help researchers export ideas and inventions from the lab to market.</td>
</tr>
</tbody>
</table>

6.25 Independence would provide an opportunity to build on such initiatives and to develop a more aligned and coherent framework for innovation in Scotland. A key goal must be to develop a virtuous cycle of activity with close collaboration between key partners in the innovation system – including universities, funding providers, firms, and public sector agencies – behind coherent strategic priorities linked to additional economic levers.

6.26 A number of areas are discussed below as illustrations –

- Overall Strategy to Innovation – Direct or Indirect Incentives
- Supporting University Research
- Financial levers to Support and Encourage Innovation
- Intellectual Property
- Attracting Skilled Workers
- The Public Sector’s Role in Innovation
Overall Strategy to Innovation – Direct or Indirect Incentives

6.27 There are a number of market failures that inhibit innovation in an economy.

6.28 These can include a disconnect between private and social returns, difficulties in securing access to finance, a lack of knowledge of the potential benefits and limited competition.

6.29 The approach towards dismantling these barriers varies across countries. A number of countries have designed specific innovation models to fit their unique circumstances and adopted a variety of policy levers to support their strengths and tackle key challenges.

6.30 In Scotland, this is not currently fully possible.

6.31 With access to the full range of policy levers, other countries – particularly relatively small countries – have developed arguably more coherent and aligned innovation policy frameworks than currently exist in Scotland. Some of these can be direct initiatives (such as research grants and funding) while others can be indirect (e.g. tax breaks and incentives).

6.32 The Finnish model for example, provides a quite different – but highly successful – model for supporting innovation.

Box 6.2: Case Study: Finland’s Funding Agency for Technology and Innovation (Tekes)\(^\text{202}\)

Finland performs strongly on measures of R&D – with the 3\(^{rd}\) highest GERD in the OECD.

Whilst it has traditionally offered few or no R&D incentives through the tax system, the Finnish government has recently introduced a tax deduction for companies based on the salaries of their R&D personnel.

Innovation policy in Finland has instead been delivered in the main through support for the Tekes Agency, which provides grants, funding and other support to businesses and research institutions undertaking R&D.

\(^\text{202}\) http://www.tekes.fi/en/
For example, it offers a range of grants supporting business R&D projects, ranging in generosity from 25% to 50% of total costs. The size of a grant depends on the project characteristics and the size of the business (with smaller firms generally receiving more generous support). Overseas businesses are also eligible for funding, as long as their work is deemed to contribute to the Finnish economy.

More generous grants of between 60% and 70% are available for research institutions including universities. Tekes also provides funding to recruit high calibre international research personnel, via the Finland Distinguished Professor programme.

The innovation system it has created forms a key part of a broader innovation and economic strategy with the institute’s activities supporting core research, collaboration across sectors and disciplines, building relationships between research institutions and firms, and supporting growth into international markets.

Supporting University Research

6.33 Scotland’s universities lie at the heart of the innovation system in Scotland. They have a global reputation with more universities in the Times Top 200 world universities per head of population than any other nation.203

6.34 The role of universities in innovation is critical. They are the primary source for ground-breaking innovations and are often the key avenue through which longer-term or more speculative research can be undertaken.

6.35 In addition to the funding provided directly for research from the Scottish Funding Council (SFC), Scotland’s universities are successful at securing research funding from a variety of sources including research councils, charities and institutions.204

6.36 Scotland’s universities (and businesses) perform strongly in securing access funding from various EU and UK-wide investment streams. For example, under the EU’s 7th Framework Programme (FP7) for research and technological development, Scotland

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204 For example, in 2011-12 of the £905 million invested by universities in R&D, almost £300 million was provided through SFC with the remainder coming from other sources (such as research councils, and charities).
secured €505 million of support over the period 2007-2013 (1.5% of total funding and almost 10% of the UK allocation).

6.37 Research is increasingly collaborative, across national boundaries. International research centres are based within Scotland, such as the Fraunhofer Institute for Applied Photonics; the European Lead Factory for the Integrated Medicines Initiative; the TSB Catapult for Offshore Renewable Energy; and the first Max Planck International Partnership in the UK.

6.38 Scottish universities have a track record of success in attracting research funding, reflecting their excellence and global reputation. The Scottish Government is committed to supporting Scotland’s universities and that will continue post-independence. The government will shortly be publishing proposals for research funding.

6.39 A clear way in which the university sector can have additional impacts on the economy, beyond their direct remit, is through the creation of a so-called ‘triple-helix’ which brings together public, private and academic bodies to support innovation and research.205

6.40 This approach has underpinned the development of the Scottish Funding Council’s Innovation Centres (ICs),206 which aim to create sustainable communities of universities, businesses and others around sectors of importance to the Scottish economy. These Centres will provide solutions to demand-led problems facing industry in Scotland by supporting innovation for future growth.

6.41 Independence, by providing clear focus of the strengths and requirements of the Scottish economy, business and academia, has the potential to strengthen the environment for this approach to flourish.

6.42 At the same time, a clear global focus boosted by distinctly Scottish international infrastructure and more visible cross-country relations would assist this process. Overall, such an approach could form part of a wider economic strategy which linked all aspects of industrial, educational, infrastructure, international and business policy.

205 The German Fraunhofer Gesselschaft is arguably the most successful.

On 13th November 2013 the Scottish Government published *Scotland CAN DO – becoming a world-leading entrepreneurial and innovative nation*, a framework that sets out a vision and ambitions for making Scotland a world-leading entrepreneurial and innovative nation. The aims of the work are to:

- Raise Scotland’s level of ambition and increase entrepreneurship and innovation activity from individuals and businesses across the country;
- Embed entrepreneurship and innovation within the whole education system;
- Increase the commercialisation of knowledge and intellectual capital and promote more collaboration between business and the academic sector both within and outwith Scotland;
- Provide a greater focus on global markets as Scottish business leaders grow in confidence and expand their horizons internationally.

The work has evolved from on-going discussions with a wide range of stakeholders, including interactive workshops held in summer 2013. An action plan will also be developed to take forward key priorities with a wide range of stakeholders across Scotland.

**Financial levers to Support and Encourage Innovation**

6.43 Independence would provide access to the key financial levers which could potentially be used – as part of the overall policy framework – to support and encourage innovation.

6.44 There would be the potential to use either direct financing levers, such as the provision of loans and guarantees; the use of competitive grants; and innovation vouchers, or indirect levers.

6.45 Indirect financing levers normally provide tax incentives aimed at encouraging innovation activities and can be applied to either expenditure (related to R&D) or income (from the benefits of R&D). Potential levers include tax credits; tax allowances; payroll tax
reductions for workers involved in R&D; and preferential tax rates on income accruing from investment in innovation.207

6.46 Such incentives can also be targeted toward specific types of firms – where there is deemed to be particular barriers to investing in R&D – such as SMEs.

Box 6.4: Case Study: Research & Development Tax Incentives in OECD countries

The UK – like other countries such as Austria, Israel and the Netherlands – currently focus on tax incentives for R&D.208

- Israel, which has the highest level of GERD and BERD as a share of GDP in the OECD, offers reduced corporation tax rates of as low as 6% for certain companies performing R&D (vs. standard rate of 25%).

- The Netherlands has a range of tax incentives. Firstly, substantially reduced payroll taxes and employer social security contributions can be claimed for employing R&D personnel up to a certain amount of wage costs (and some other related costs up to a maximum). Secondly, non-wage R&D expenditure is tax deductible at a rate of over 150%. Finally, profits from innovations are taxed at 5% (standard rate of 20-25%) under an 'Innovation Box'.

- Austria offers a volume-based tax credit of 10% on qualifying R&D expenditure. The credit is refundable to the extent that it exceeds the actual tax liability. Eligibility is not limited by industry, and both basic and applied research are permitted. Furthermore, for individuals only, all income related to royalty payments or capital gains from self-developed IP is taxed at half the usual rate.

It is worth noting that many of the top performing countries for R&D expenditure such as Finland, Sweden, Switzerland and Germany have generally offered limited or no tax incentives for R&D, instead preferring to administer support via grants and more direct funding.209 The key point is that individual countries have adopted the model that works best for them.

6.47 Tax incentives for R&D are clearly a popular measure to adopt. Where a country has low levels of R&D embedded into its business model in the first place more direct intervention – through for example a technology and innovation centre of the type described in Box 6.2 – may also be attractive. As highlighted above, the balance between direct and indirect support is an important area for policy to consider post-independence.

6.48 Related to this, alongside shaping the level of support offered, there is also the potential to consider both the criteria for allocating funding and the range of activities eligible. These criteria will be determined by the unique circumstances of a country.

6.49 The Technology Strategy Board (TSB) provides funding for innovation, and its wide range of programmes and competitions are open to applicants from across the UK.

6.50 Under the current structure, however, Scotland’s ability to contribute to the policy direction of the TSB is limited, which means that it may not always be in line with Scottish industrial or research strengths. Therefore, where there is a joint interest in priorities between Scotland and the rest of the UK – and it is to the mutual benefit of both countries – an independent Scotland could seek to continue to work with the TSB to deliver on shared objectives. Where priorities diverge, under independence future Scottish governments would have the opportunity to develop policy approaches which addressed specific needs.

**Intellectual Property**

6.51 Under the current system, the UK Patent Office is responsible for managing intellectual property (IP), although much of IP regulation comes from the EU.

6.52 An effective IP system can be a powerful force for economic development and growth. The 2011 Hargreaves Report recognises this and makes a number of recommendations on how the UK system can be adapted to ensure that the IP framework is better suited to supporting innovation and promoting economic growth in the digital age. The report highlighted how reforming the IP system could result in stronger rates of innovation and increased economic growth.

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6.53 However, some commentators have also raised concerns that patent systems can often be a block to innovation. For example, “The Gridlock Economy”\textsuperscript{211} notes that “Innovation has moved on, but we are stuck with old-style ownership that’s easy to fragment and hard to put together”.

6.54 Under independence, future Scottish governments would be able to consider the extent to which the current system was appropriate to Scotland’s needs. For example, the UK is one of only a small number of countries which does not offer a “2nd tier” protection scheme which covers the basics of IP protection and is cheaper and quicker to access. Scotland could follow, for example, the German 2\textsuperscript{nd} tier (or utility) model which provides greater protection of technical innovations.\textsuperscript{212}

6.55 Another area that could be considered is how Scotland could make use of intellectual property as a means to finance and support innovation. The European Commission has recently published a report into the valorisation of intellectual property\textsuperscript{213} which proposes routes to “create value from patents by capturing and extracting their latent economic potential through developing and commercialising the underlying technology”.

6.56 The expected benefit of these measures would be to unlock the innovation potential of patented technologies that are currently underexploited. An independent Scottish Government could support companies to realise gains that would come from trade of patents and licenses, leading to a more extensive use of such patented technologies. In the longer term, patent holders could benefit from part of these gains and so make it more likely that they would have additional incentives to invest in R&D, as well as bringing the benefits of exploitation to the wider economy.

**Attracting Skilled Workers**

6.57 Scotland is an attractive place to live and the strengths of Scottish universities provides scope to recruit the best in the world. In the modern world, such competition is fierce. However, policies to attract skilled talent to Scotland are largely out-with the powers of the Scottish Government.


\textsuperscript{212} http://europa.eu/youreurope/business/start-grow/intellectual-property-rights/

\textsuperscript{213} http://ec.europa.eu/enterprise/policies/innovation/files/options-eu-instrument-patent-valorisation_en.pdf
6.58  Top researchers are highly skilled, and globally mobile. Scottish universities recruit
talent from across the world, whilst many Scottish researchers work in institutions in other
countries.

6.59  A concern raised by universities is that current UK immigration policy has made it
more challenging for Scottish universities to recruit world class researchers. It is estimated
that 28% of academic staff in Scotland are from outwith the UK.\footnote{http://www.royalsoced.org.uk/cms/files/events/programmes/2012-13/speaker_notes/LindsayPaterson.pdf}

6.60  There are also instances where firms operating in Scotland have raised the attraction
of talent into key sectors in Scotland as an issue.\footnote{http://www.barclayscorporate.com/content/dam/corppublic/corporate/Documents/research/oil-and-gas-report.pdf}

6.61  In Life Sciences for example, the attraction of international talent at a level that
supports high growth companies to move to the next level of development is a key part of

6.62  Independence would provide an opportunity for future Scottish governments to put in
place initiatives to attract skilled workers to Scotland and to meet the specific needs of the
Scottish economy. For example, consideration could be given as to whether the post-study
work visa could be reintroduced in order to encourage non-EEA (European Economic Area)
students to pursue their university education in Scotland.

The Public Sector’s Role in Innovation

6.63  As highlighted above, the public sector also has an important – although often
overlooked – role in boosting innovation.

6.64  This comes through a number of avenues – both the way in which the government
procures and directs innovation in the public sector.

\footnote{http://www.royalsoced.org.uk/cms/files/events/programmes/2012-13/speaker_notes/LindsayPaterson.pdf}
\footnote{For example, in a recent Barclays report, 66% of those surveyed identified “skilled labour
shortage” as the biggest challenge facing the oil and gas industry. http://www.barclayscorporate.com/content/dam/corppublic/corporate/Documents/research/oil-and-gas-report.pdf}
In the spending that it does control, the Scottish Government currently looks to remove barriers for SMEs and to encourage innovation in public sector contracts. In an independent Scotland, Scottish governments could do this with an increased range and scale of procurement opportunities, including projects in which firms are well-placed to innovate and grow. As NESTA puts it in “Plan I”, Government can act as “a supportive first customer”.  

A public authority may act as the lead user and offer a test environment for new ideas, completing their functional testing and proving performance. Catalytic procurements of this type aim to reduce market risk for companies and speed up market access and are an approach that is currently being explored in Finland. 

Pre-commercial procurement approaches, such as the Small Business Innovation Research (SBIR) scheme in the USA and the SBRI programme run by the UK’s Technology Strategy Board, allow firms to collaborate with the public sector on market driven projects to help them develop innovative solutions for specific public sector needs. Similar policies could be developed, designed and implemented in an independent Scotland – targeted to local needs.

Box 6.5: Case Study: Innovation in Health - The Scottish Collaborative Innovation Partnership Process

Government can play a direct role in stimulating innovation, and, using a challenge based approach, can work together with industry and stakeholders to develop solutions to real life public sector issues. The Scottish Government is now using this model to take forward innovation in health care in a way that supports the development of innovative products.

NHS Scotland has a Vision for 2020 that everyone will be able to live longer healthier lives at home, or in a homely setting. An important component of this is to move the focus of care and support away from the hospital to communities and homes. This will not only improve service quality and the experience of users, but make better use of all available resources. The vision is one of transformational change, not incremental improvement. To make this happen, innovative models of care and different ways of working must be created and adopted.

NESTA (2012) “Plan I: The case for innovation-led growth”

http://www.tekes.fi/about/publicprocurements/background
The Scottish Collaborative Innovation Partnership Process (SCIPP), aims to bring together ideas and people to address this challenge. The best ideas to emerge will, under sponsorship from the government, be developed, supported and scaled through appropriate support mechanisms including NHS procurement, NHS planning, partnership working and the Technology Strategy Board’s Small Business Research Initiative programme.

Conclusion

6.68 Independence – in providing access to the economic levers to support and encourage innovation – would present an opportunity to develop a fully aligned and coherent framework for supporting innovation in Scotland.

6.69 Scottish governments currently have limited opportunity to shape policy levers to deliver a clear strategy for Scotland which encompasses all the various aspects of the innovation system. Key tax powers are reserved to the UK, while the legislative, revenue and legal frameworks to establish more grants/funding support is also constrained.

6.70 A key goal of such a new framework would be to develop a virtuous cycle of innovative activity with close collaboration between key partners in the innovation system – including universities, funding providers, firms, and public sector agencies – behind strategic priorities. This coherence could be achieved through the establishment of an Innovation Agency or Institute, such as the model pursued in Finland.

6.71 The additional levers may be used in a number of ways to support such an approach, for example:

- Establishing a framework – including the balance of direct and indirect innovation support – which supports activity across the private and public sectors in Scotland;
- Providing tax incentives aimed at encouraging innovation activities, such as through tax credits, tax allowances or payroll tax incentives for hiring workers involved in R&D;
- Incentives could be targeted at specific barriers which limit investment in R&D (for example by SMEs);
- Considering the extent to which the current system for intellectual property reflected Scotland’s needs;
• Putting in place initiatives to help ensure that the best skilled researchers from across the world are attracted to work in Scotland;
• Encouraging innovation in public sector contracts with an increased range and scale of procurement opportunities.

6.72 Supporting businesses and improving competitiveness is also dependent on labour market performance, this is discussed in the next chapter.
Chapter 7: A Labour Market that is Resilient, Adaptable and Inclusive

Chapter Summary

- Scotland boasts a highly skilled and dynamic workforce. Performance, on key indicators such as employment and unemployment, is comparable with the UK and internationally.
- With the powers that are devolved, successive administrations have targeted initiatives to Scotland’s strengths and weaknesses. As Chapter 2 highlighted, performance has improved since devolution.
- Like many other countries Scotland faces a number of challenges. These include regional variations in performance, long-term unemployment, underemployment, job security, in-work poverty and inequality.
- Many of these have increased as a result of the recession.
- Key policy levers that impact on the labour market are reserved.
- Independence would provide an opportunity to put in place a new economic framework – supported by a strong social partnership approach – that attaches greater value to positive labour market outcomes.
- It would also create greater opportunities to establish a more coherent framework linking devolved levers such as education and employability with a more supportive business environment.
- The tax and welfare systems could be better aligned, incentivising employment and ensuring that those who can work are supported to do so. It would also allow a more effective, integrated support for those seeking employment.

Introduction

7.1 A strong and productive labour force is central to long-term economic success. Valued work that leads to sustainable employment is vital to maximising all of Scotland’s economic potential.
7.2 It is also a key avenue for tackling a range of social issues from poverty and income inequality to health and life expectancy.219

7.3 Over the long-term, the private sector is the greatest creator of employment opportunities. It is vital therefore that government policy facilitates such growth. At the same time, however, the public sector plays a vital role in a modern mixed economy and it too has an important contribution to make.

7.4 Too often policy focus is centred on the level of employment as the sole objective. In reality, the type of employment, the level of job security, the flexibility of the workforce, the rewards and benefits and equality of opportunity, are just as important. This is something that, the Scottish Government believes, the current UK economic model and approach to policymaking often ignores.

7.5 A labour market which is resilient, adaptable to changes in economic conditions, and able to respond quickly to new opportunities and challenges can be a major comparative advantage.

7.6 With the powers that are devolved, successive administrations have targeted initiatives to Scotland’s unique circumstances.

7.7 The Scottish Government has adopted a strong social partnership approach, working with the third sector, unions, employer associations and employers directly. But the scope is necessarily constrained by the limits of devolution. Independence could facilitate a stronger partnership approach. This would not happen overnight but – as a long-term ambition – a partnership could be expanded more widely into the private sector using the powers of independence and recent experiences within the public sector.

7.8 Independence would create greater opportunities to establish a coherent framework, linking supply side levers such as education, employability and welfare with a more supportive business environment to foster job creation.

7.9 Specific policies – such as the tax and welfare system – could be better aligned to support employment and job outcomes.

7.10 As with any policy action, there would be choices and responsibilities to be prioritised. While some gains could clearly be made from more efficient application of policies, any specific additional initiatives need to be affordable and balanced alongside competing priorities.

Scotland’s Labour Market

7.11 While the overall picture is strong, Scotland’s labour market - like many other countries - faces a number of challenges. In some cases, some of these have become more pronounced due to the recession, whilst others have persisted for decades.

7.12 Such challenges often affect specific groups of individuals and can be concentrated in particular geographical locations.

7.13 Four key areas are discussed below –

- Headline Labour Market Indicators
- Qualifications profile
- Skills profile
- Wages and in-work poverty

Headline Labour Market Indicators

7.14 Scotland’s labour market has strengthened in relative terms over the past decade.

**Key Facts:**

Over the 3-month period July-September 2013:

- Scotland’s employment rate was 72.8%, compared to the UK rate of 71.8%.
- Scotland’s unemployment rate was 7.2% compared to the UK rate of 7.6%.
7.15 Scotland compares relatively favourably internationally. Over the period 2004-2012, the average OECD unemployment rate was 7.1% with an average employment rate of 65.4%. Comparable Scottish averages are 6.3%, and 71.0%, respectively.\textsuperscript{220}

7.16 However, other countries do better. In Norway, the average unemployment rate was 3.3% between 2004 and 2012, and in Iceland the average employment rate was 81.6% over the same period.

7.17 As a result of the recession, employment has fallen in Scotland whilst unemployment has risen. Ensuring that the recovery generates sufficient sustainable and good quality jobs so that such changes are temporary will be vital.

7.18 There are long-standing gender differences with women tending to be less active in the labour market than men - although female participation rates in Scotland have improved over the last decade or so and are slightly stronger than for the UK as a whole.

\textbf{Figure 7.1: Employment Rate by Gender (16-64), Scotland, UK, 1997-2013 (Seasonally Adjusted)}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{employment_rate.png}
\caption{Employment Rate by Gender (16-64), Scotland, UK, 1997-2013 (Seasonally Adjusted)}
\end{figure}

Source: LFS November 2013

\textsuperscript{220} EuroStat and Annual Population Survey, ONS
7.19 Employment varies by age, with lower rates for younger workers (aged 16-24) – although this partly reflects participation in education – and older workers (aged 50-64).

**Figure 7.2: Employment by Age Group, Scotland, Labour Force Survey: Jul-Sept 2013**

7.20 Much of the focus of government intervention centres on boosting opportunities for young people either in work or education. Research shows that periods of unemployment at a young age can have a particularly harmful impact on an individual’s long-term labour market prospects.221

**Key Fact:** In July - September 2013 Scotland’s youth (16-24) employment rate was 56.6% compared to 52.1% in the UK.

7.21 Labour market outcomes vary across Scotland – for example employment rates ranged from 59.7% in Glasgow to 81.3% in Orkney during 2012 (Scotland average of 70.6%).222

7.22 In certain areas, long-term unemployment is a challenge. Over the 3-month period July-September 2013, 33% of unemployed people in Scotland had been unemployed for more than 12 months.223

222 Annual Population Survey 2012
223 ONS analysis of LFS Microdata
7.23 As highlighted above, it is not just the level of employment and unemployment that is important. Some workers, while in employment, are underemployed. Underemployment can either be time based (i.e. looking to work additional hours, either in the same job, in an additional job or in a new job) or skills based. Just over 40% of underemployment in Scotland is accounted for by people working part-time in the private sector.

Table 7.1: Underemployment in Scotland and UK, Jul-Sep 2013

<table>
<thead>
<tr>
<th></th>
<th>UK</th>
<th>Scotland</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Rate</td>
<td>Level (000s)</td>
</tr>
<tr>
<td>2008</td>
<td>7.7%</td>
<td>2,249</td>
</tr>
<tr>
<td>2009</td>
<td>9.9%</td>
<td>2,838</td>
</tr>
<tr>
<td>2010</td>
<td>10.4%</td>
<td>3,002</td>
</tr>
<tr>
<td>2011</td>
<td>10.4%</td>
<td>2,981</td>
</tr>
<tr>
<td>2012</td>
<td>10.8%</td>
<td>3,162</td>
</tr>
<tr>
<td>2013</td>
<td>10.6%</td>
<td>3,132</td>
</tr>
</tbody>
</table>

Source: Labour Force Survey, Jul-Sep 2013, not seasonally adjusted, ONS

Key Fact: In July-September 2013, 244,000 individuals in employment in Scotland were underemployed.

Qualifications profile

7.24 In recent years, there has been a steady decrease in the percentage of working age adults with low or no educational qualifications (SCQF Level 4 or below), falling from 16.4% in 2007 to 13.0% in 2012.\(^\text{224}\)

7.25 Scotland compares well internationally – Figure 7.3.\(^\text{225}\)

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\(^{224}\) http://www.scotland.gov.uk/About/Performance/scotPerforms/indicator/skill

\(^{225}\) The EU 21 average is calculated as the unweighted mean of the 21 countries that are members of both the European Union and the OECD for which data are available or can be estimated. These 21 countries are Austria, Belgium, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, the Netherlands, Poland, Portugal, Slovenia, the Slovak Republic, Spain, Sweden and the United Kingdom.
Skills profile

7.26 In general, feedback from employers on the skills-base in Scotland is positive. For example, the UK Employer Skills Survey 2011 found that in the previous 2-3 years, 27% of Scottish employers recruited a leaver from Scottish education, with employers finding that they were well prepared for work.\footnote{Employers are asked to what extent they found new recruits well prepared for work. ‘Well prepared’ is a general measure of work-readiness and is self-defined by the employer (the respondent to the survey).} This perceived level of work-readiness increased with time spent in education.\footnote{These figures are taken from the UKESS report: http://www.ukces.org.uk/publications/employer-skills-survey-2011. It presents results using survey weights to allow comparison between UK nations. Slightly different results for Scotland are available from http://www.ukces.org.uk/publications/er65-employer-skills-survey-11-scotland - which uses weights designed to allow comparison with previous Scottish skill surveys.}
Wages and in-work poverty

7.27 Median gross weekly earnings of those working full-time in Scotland were the 3rd highest in the UK. However, there are significant variations across the population. In 2012, median gross weekly earnings for full-time employees were £95.70 higher for men than women. There are also significant variations by employment type.

7.28 There is evidence that wages as a share of overall income have declined over recent decades. Such data is only available for Scotland for recent years, however, UK data suggests that ‘compensation of employees’ as a share of GDP has been on a downward trend. Coupled with increasing income inequality, this could explain, in part, the rise in indebtedness witnessed over the same time period. This again, arguably, reflects a worrying trend in the UK economy.

Figure 7.4: UK Compensation of Employees as Percentage of GDP, 1955-2013

7.29 Sustainable – and well-paid – employment opportunities are key to tackling poverty and income inequality.

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228 SG Analysis of ASHE microdata. ASHE, ONS.
7.30 Although work provides a positive outcome, low pay is an issue in Scotland with 18% of employees (or 418,000) earning less than the living wage in 2012.\textsuperscript{229,230}

7.31 Households where at least one member is working (either full or part-time) but where household income is below the poverty threshold are classified as living in in-work poverty. In 2011/12, 280,000 individuals in Scotland were living in in-work poverty – Figure 7.5.\textsuperscript{231}

**Figure 7.5: Percentage of individuals in Scotland in in-work poverty (relative poverty before housing costs): 1998/99 – 2011/12**

![Image of Figure 7.5](image-url)

Source: HBAI, DWP

7.32 Improving labour market outcomes, tackling poverty and inequality and supporting economic growth are not mutually exclusive objectives. Indeed, as the OECD have highlighted,\textsuperscript{232} well-designed labour market policies and institutions not only reduce inequality but also boost the economy.

\textsuperscript{229} A living wage is defined as a wage that gives individuals and families enough income to meaningfully participate in society, rather than merely provide the minimum income necessary for basic necessities. The current living wage is £7.45 in Scotland compared to the current minimum wage of £6.31 per hour.

\textsuperscript{230} http://www.scotland.gov.uk/Resource/0042/00425244.pdf Source: ASHE 2012, ONS


7.33 Finally, an increasing concern is job security (e.g. zero hours contracts). While there are clearly nuances to each case – for example, flexibility can be important in particular contexts – any general trend towards less secure work is a concern.

7.34 In summary, while Scotland performs relatively strongly relative to the rest of the UK on many key indicators, there is clear scope for improvement. Many of the challenges that Scotland faces are long-standing and the Scottish Government believes that a new approach is required.

**Opportunities for Labour Market Policies in an Independent Scotland**

7.35 Under the current devolution framework, whilst the Scottish Government has devolved responsibilities for education and skills, it has no powers over employment regulation, employment services, tax or welfare policies, all of which are crucial to supporting people to enter and remain in employment.

7.36 The Scottish Government believes that this inhibits the opportunity to provide a coherent and fully effective solution to tackle key labour market challenges.

7.37 At the same time, there is an inherent inefficiency in the current framework with regard to funding such initiatives. For example, where Scottish Government policy – such as skills, modern apprenticeships – are successful in moving people into the labour market or up-skilling those in employment, the returns, in the form of tax and national insurance receipts and/or lower benefit payments, accrue to the UK Government. This means that such improvements cannot be re-invested to continue to tackle key labour market challenges.

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Box 7.1: Scottish Government Actions Current Actions to Support Labour Market Performance

With the powers available, the Scottish Government has taken a multi-faceted approach in its strategy to support employment and in particular, the challenges regarding youth unemployment. Key actions include -

- The appointment of the first dedicated Minister for Youth Employment.
- The commitment to provide 25,000 new apprenticeship opportunities in each year of the parliament.
- ‘Opportunities for All’ which offers an appropriate place in learning or training for all 16-19 year olds not in education, employment or training.
- Between 2012 and 2015, £30 million will be invested to support a variety of youth employment initiatives.
- Over a billion pounds a year to be invested in higher education.

The Employability Fund, created in 2013-14, is a £52 million fund which draws together investment from the Scottish Funding Council and Skills Development Scotland in pre-employment training, ensuring provision is better tailored towards the needs of participants and local labour markets.

In the remainder of the chapter, key policy levers that would be open to Scotland post-independence are discussed. A key feature of the discussion is the importance of exploiting synergies between different policies, from taxation through to welfare and employability.

Greater Coherence and Social Partnership

7.38 With independence, future Scottish governments would be able to create a more coherent framework linking the full range of supply side policies with wider tax and demand policies.

7.39 This could be built around a strengthened social partnership approach to tackling labour market challenges, which directly linked government, the third sector, unions, employer associations and employers.

7.40 Bringing together labour market regulation and other employment-related policies in forums which encourage direct and constructive dialogue across all key stakeholders could
be a major advantage – Box 7.2. This could, in principle, range from a focus on high-level issues such as labour market reform, to sector specific issues such as addressing skills-shortages in key sectors, particular policy initiatives such as the Living Wage, or promoting equal opportunities. Scotland’s size, and the opportunity to bring together key stakeholders, could be a key asset.

Box 7.2: Case Study: Relationship between Government, Employers and Employees

Scandinavian countries have built - over time - highly valued relationships between government, employer associations and trade unions. For example -

- In Finland, almost all labour market legislation is based on a consensus between government, unions and employer associations.\(^{234}\) For example in 2011, the centralised agreement on wages and conditions between employers and employees was agreed with government support which promised measures to support the agreement (including a 0.5 percentage point cut in corporation tax).\(^ {235}\)

- In Sweden, labour market regulation is based largely on collective agreements between trade unions and employer organisations (the social partners).\(^ {236}\) Legislation ensures that the social partners have responsibility to regulate pay and employment conditions. Any changes to employment legislation are openly discussed by government and the social partners.

- Denmark has minimal formal labour market regulation with key labour market issues regulated through agreements between employers and employees. Although Denmark does not have a formal agreement between government and social partners, it relies upon a productive but more informal relationship. Traditionally the social partners have regulated wages and working conditions whilst the government has regulated welfare through legislation.\(^ {237}\) However, recently welfare and social affairs have increasingly emerged as issues in collective agreements.

- In Norway, strong labour relations constitute an important part of their model of growth and social equality, characterised by strong employer and employee organisations and

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close co-operation between government, employers’ associations and trade unions, as well as by strong co-determination and participation at company level. Alongside this, policies are targeted to deliver accompanying wage equality, social mobility, high employment (male and female) and universal welfare arrangements.

7.41 The challenges of establishing such a framework should not be underestimated. However, the Scottish Government believes that it should be a clear ambition – deliverable in a country of Scotland’s size – and could be a real advantage to business competitiveness, labour market outcomes and the resilience of the economy.

7.42 In addition to the opportunities to tailor the institutional framework in which policy is set and developed, independence would provide a number of important new policy levers that could be targeted to the particular circumstances and challenges for Scotland.

Taxation and the Welfare System

7.43 As highlighted by the Fiscal Commission Working Group in its paper *Principles for a Modern and Efficient Tax System in an Independent Scotland*, a key aim of a newly designed tax system for Scotland should be for it to work more closely with the benefit systems. This could help incentivise and support people into work.

7.44 This would allow Scottish governments to consider how the different methods of taxation – income, expenditure and wealth taxes – were applied to meet desired aims, such as the returns from employment.

7.45 As noted by the Fiscal Commission Working Group, the existing provision and withdrawal of different types of benefits and tax credits interacting with income tax and National Insurance payments can result in complexities and variations in the effective marginal tax rate.

7.46 In the example below, a single adult in work earning £9.50 per hour with two children faces a complex tax structure of marginal tax rates depending upon when various

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allowances, benefits and tax credits are added/taken away.\textsuperscript{240} Such effects can have significant implications for the returns to work (both real and perceived) and on work patterns.

\textbf{Figure 7.6: Effective Marginal Tax Rate, 2013-14}

\begin{figure}
\centering
\includegraphics[width=\textwidth]{effective_tax_rate.png}
\caption{Effective Marginal Tax Rate, 2013-14}
\end{figure}

\textbf{Employability and Welfare}

7.47 The discussion above highlights the links between the tax and welfare system, and the need for both to be considered alongside one another in design and operation.

7.48 The welfare system also links closely to employability policies.

7.49 The Expert Working Group on Welfare is considering the principles and policies that could underpin a welfare system in an independent Scotland.\textsuperscript{241}

7.50 Independence would allow the Scottish governments to prioritise more effective, integrated support for those seeking employment which was better linked to welfare.

\textsuperscript{240} Modelling based on a single parent with two children aged 5-10 living in the Social Rented Sector with weekly housing costs of £100, and earning £9.50 per hour.

\textsuperscript{241} http://www.scotland.gov.uk/Resource/0043/00434558.pdf
7.51 Under the current system, employment services, benefits, tax credits and taxation are reserved whilst training for employment is effectively a shared responsibility between the UK and Scottish Governments.

7.52 The current system leads to potential overlaps and duplication of provision and resource. The same level of resource could be better spent but generate more impact.

7.53 In an independent Scotland, the development of a single agency approach - removing the institutional barriers between the job brokering service and employability programmes offered, in Scotland, by DWP and support provided through Skills Development Scotland - could facilitate better alignment of services and coordination of skills and training programmes to deliver a more streamlined and efficient system. This could particularly benefit those most in need of support.

7.54 This, in turn, should help more people to move into sustained work, with those in low paid, low skilled jobs supported to develop the skills to progress in-work and move out of poverty.

7.55 This can be achieved through a variety of possible avenues including –
- improved alignment of services for the unemployed;
- a move to an early intervention model which seeks to reduce long-term unemployment;
- better opportunities for young people who are in the benefits system to build on progress already made within the post-16 education system; and
- delivery of a coherent pre-employment and workforce development service within the wider economic growth agenda.

7.56 Closer alignment of the current reserved and devolved powers would also ensure that the Scottish Government is better able to reinvest savings made into new programmes.

7.57 Alongside this, independence would also create the opportunity to develop a more integrated approach between welfare and other public services such as health, housing and social care. This will mean that when people’s circumstances change through ill health, unemployment or retirement, they can receive better and more integrated support which can help plan for the longer term with greater certainty.
Finally, the tax system is not only important in influencing overall levels of income, but can also potentially impact the demand for labour. A potential policy approach, as highlighted in Chapter 5, is through changes to employers National Insurance Contributions (NICs).

For example, in Budget 2013 the UK Government announced that an Employment Allowance policy - a £2,000 a year reduction in NICs for all businesses and charities – would be introduced in April 2014. The £2,000 allowance is per employer and although every business will get the allowance (1.25 million according to UK Government estimates), it will constitute a proportionately larger reduction in the NI tax bill for smaller firms.

**Employment Legislation**

Employment regulation includes minimum terms and conditions, maternity and paternity rights, equal opportunities, equal pay between women and men, the rules around unions and collective bargaining, and the minimum wage.

Well-designed labour market policies and institutions can reduce inequality.

While each element of employment regulation has its own impact, taken together as a system, they need to balance the twin objectives of protecting the rights of employees and encouraging and empowering employers to grow and create good quality jobs.

Under the current framework, employment and labour market regulation is reserved. UK legislation and policy must, however, be compatible with the EU’s legal framework. An independent Scotland, as a member state, will require to meet all EU requirements.

Analysis by the OECD suggests that the UK is one of the most lightly regulated labour markets amongst developed countries.

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243 The UK Government says 90% of benefit will go to small businesses with fewer than 50 employees – see https://www.gov.uk/government/news/employment-allowance-boost-for-business-bill-introduced-to-parliament

244 http://www.oecd.org/eco/labour/49421421.pdf

245 http://www.oecd.org/employment/emp/oecdindicatorsofemploymentprotection.htm
7.65 Whilst the OECD recognises that the UK’s greater labour flexibility that is a consequence of this may have acted to maintain employment during the financial crisis beyond initial expectations, it has also highlighted that this has come at the price of underemployment and lower wages especially for low skilled workers.\textsuperscript{246} So whilst more people have retained paid employment, it can also be argued that they are working fewer hours and/or for less pay (often with less job security).

7.66 The UK Government has made a virtue of the fact that it has some of the least strict employment protection regulation in the OECD.\textsuperscript{247}

\textbf{Figure 7.7: Protection of Permanent Workers Against Individual and Collective Dismissals, 2013}\textsuperscript{248}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{figure7_7.png}
\caption{Protection of Permanent Workers Against Individual and Collective Dismissals, 2013}
\end{figure}

\textsuperscript{248} Data refer to 2013 for OECD countries and Latvia, 2012 for other countries. The figure presents the contribution of employment protection for regular workers against individual dismissal (EPR) and additional provisions for collective dismissal (EPRC) to the indicator of employment protection for regular workers against individual and collective dismissal (EPRC). The height of the bar represents the value of the EPRC indicator. Source: OECD http://www.oecd.org/employment/emp/oecdindicatorsofemploymentprotection.htm
7.67 Others may argue that an approach that limits rights regarding notice period, severance pay and unfair dismissal might not be the best approach to improve the economy or well-being. As the chart highlights, Germany is above the OECD average in terms of employment protection. It also scores highly however, on productivity, exports, and output per head.

7.68 A common mistake is to confuse a lightly regulated market with a flexible one. Denmark and other countries show that this need not necessarily be the case.

7.69 With respect to regulatory institutions, an independent Scotland could consider bringing together employment-related matters under one body, with the possibility for Scotland to have its own Employment Rights Authority, similar to other countries, such as the National Employment Rights Authority in Ireland.249

7.70 An aim of such an approach could be to deliver greater consistency and stability for employers and employees and deliver cost savings. It would also be consistent with a move toward a greater social partnership approach.

7.71 Carefully designed employment protections can have other benefits including:

- supporting a “high road” to productivity gain with investment in training and capital, and a move from low wage/low cost to value-added business models;
- helping employees strike a balance between non-market activities, such as care of young children or older people, and paid work. Maternity and paternity leave and return-to-work rights, for example, have a direct impact on female labour force participation; and,
- employment protections, and the wider equality and human rights legal framework, can also support individuals faced with institutional power imbalances.

7.72 Whilst the UK Government requires firms to report the number of men and women on their boards,250 and has a target to increase the number of women on FTSE 100 boards to 25% by 2015,251 a number of European countries have adopted a more progressive attitude

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to worker and gender balance on company boards. For instance, Belgium, Italy, France, Iceland and Norway have already introduced legislation requiring a gender quota on boards.\textsuperscript{252}

7.73 There is some evidence to suggest that companies with greater levels of diversity actually perform better.\textsuperscript{253} Control over both equality and employment legislation would allow an independent Scotland to consider the full range of options and develop a distinctive Scottish approach to address underrepresentation and achieve a more balanced workforce.

\textbf{Minimum Wage and Bargaining}

7.74 Under independence, future Scottish governments would have responsibility for the minimum wage.

7.75 The Scottish Government fully supports the living wage and its overarching principle to reward their staff fairly – this commitment covers 180,000 people in Scotland working for central government, agencies and the NHS.

7.76 Policies on the minimum wage theoretically involve a trade-off between employment and inequality. A relatively high minimum wage can narrow the distribution of income but if it is set too high, there may be negative impacts on employment. The empirical evidence from the UK minimum wage has not shown significant evidence that the adult NMW has reduced employment.\textsuperscript{254} Independence would provide an opportunity for decisions around the level of the minimum wage to be set according to the priorities and preferences of the people of Scotland and critically the opportunity to re-invest any higher tax revenues or savings from lower associated supplementary income benefits that would result.

7.77 Box 7.3 outlines the approach taken in the UK by the Low Pay Commission (LPC) and similar approaches in other countries.

Box 7.3: Case Study: Relationship between Government, Employers and Employees

Scandinavian countries have built - over time - highly valued relationships between government, employer associations and trade unions. For example -

- In Finland, almost all labour market legislation is based on a consensus between government, unions and employer associations. For example in 2011, the centralised agreement on wages and conditions between employers and employees was agreed with government support which promised measures to support the agreement (including a 0.5 percentage point cut in corporation tax).

- In Sweden, labour market regulation is based largely on collective agreements between trade unions and employer organisations (the social partners). Legislation ensures that the social partners have responsibility to regulate pay and employment conditions. Any changes to employment legislation are openly discussed by government and the social partners.

- Denmark has minimal formal labour market regulation with key labour market issues regulated through agreements between employers and employees. Although Denmark does not have a formal agreement between government and social partners, it relies upon a productive but more informal relationship. Traditionally the social partners have regulated wages and working conditions whilst the government has regulated welfare through legislation. However, recently welfare and social affairs have increasingly emerged as issues in collective agreements.

- In Norway, strong labour relations constitute an important part of their model of growth and social equality, characterised by strong employer and employee organisations and close co-operation between government, employers’ associations and trade unions, as well as by strong co-determination and participation at company level. Alongside this, policies are targeted to deliver accompanying wage equality, social mobility, high employment (male and female) and universal welfare arrangements.

Evidence from the OECD shows that the wider institutional arrangements need to be considered when setting the minimum wage. Box 7.4 demonstrates the role that Works Councils play in Germany. Under independence, there is no reason why Scottish specific arrangements could not put in place, perhaps looking to the experiences of countries such as Germany and also the success of the Low Pay Commission in the UK, for example, through more specific forums to discuss wage and work design on a sector basis.

Box 7.4: Case Study: Collective Bargaining and German Work Councils

There is evidence that wage inequality is generally lowest in countries where bargaining is coordinated. Germany is widely regarded as a strong example of a highly productive, and more equal, labour force. German work councils work on the basis of co-determination.

Work councils in Germany have led to a strong worker influence in firms despite a relatively low level of union density of 18.0%, compared with Scotland (31.7%) and the UK (26.0%). In firms with more than 500 workers, board-level worker participation is a legal requirement. This board-level worker participation comes in the form of a supervisory board that the firm’s management reports to.

Workers make up one third of supervisory boards in firms of 500-2,000 employees, rising to half for firms with over 2,000 employees. There is a legal basis for worker participation in all private sector firms with five or more employees.

While work councils in Germany have the right to co-determination, they do not have the right to bargain or to call strikes. They do, however, have the right to consultation on restructuring and jobs.

Clearly implementing such a scheme in Scotland would represent a fundamental change and may not be most appropriate in all Scottish circumstances. However, it is an option for

262 Co-determination means that workers play a role in the management of the firm. http://www.worker-participation.eu/National-Industrial-Relations/Countries/Germany/Workplace-Representation
263 OECD Statistics Trade Union Density 2011, 2012 data is not available for Germany.
265 http://www.worker-participation.eu/National-Industrial-Relations/Countries/Germany/Board-level-Representation
future governments to consider if it were subject to proper design and consultation alongside an overarching approach to employment legislation, industrial strategy and business competitiveness.

Workforce development

7.79 Independence would enable future Scottish governments to seek innovative ways to support improvements in the productivity and well-being of the workforce. For example, future Scottish governments could consider the potential to establish more of an integrated focus to workplace development, innovation and skills utilisation to better align the supply of skills with the needs of employers.

7.80 The UK Commission for Employment and Skills Employer Skills Survey of 2011 highlighted that 68% of firms in Scotland surveyed had provided some form of training in the last year – higher than the UK average of 59%. However, there are variations in the incidence of training across firm size, sectors and occupations.

7.81 In the UK, 48% of firms who trained their workers would have liked to provide more training. The most common barriers to further training were either financial constraints or staff time.

7.82 Through access to the full range of economic policy levers there would be more opportunities to incentivise employers to invest in training and development. Similar schemes are in place in the UK, but could be integrated and refined to the particular Scottish situation. Key priorities could include –

- **Targeted financial support** – funding provided to employers in the form of grants or training vouchers. For example, the Australia Apprenticeship Incentive Programme (AAIP) provides staged tax-free incentives to employers who take on an apprentice.

- **Taxation** – for example tax allowances, credits, or exemptions (for example, through employer social security contributions). The Netherlands Payment

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Reduction for Education (WVA) scheme\textsuperscript{268} – through a payroll tax credit – currently compensates employers for loss of working time as a result of employees undertaking certain types of training; and

- \textit{Levies} – compulsory / voluntary contributions to training funds, or sanctions for non-training firms. Through the Ireland Skillnets Training Network, the Irish Government matches up to 50\% of any employer contributions raised through a compulsory levy of 0.7\% on the payroll.\textsuperscript{269} This is primarily aimed at SMEs and the funds are distributed around a network of firms across the country.

7.83 At the same time, there could be a greater approach to work-place design and progression (particularly in high participation employment areas).

\section*{Incentives to recruit certain types of workers}

7.84 As already highlighted, certain groups in Scottish society have lower economic activity rates than the average, reflecting particular additional barriers. For example, in 2012 the employment rate for disabled people was 45.6\%, considerably below the overall employment rate of 70.6\%.\textsuperscript{270}

7.85 Through access to the full range of economic policy levers, there would be new opportunities to incentivise employers to recruit certain types of workers –

- \textit{Direct financial support} – direct funding provided to employers in the form of subsidies, grants or financial assistance for example to help employ workers with a disability. These are designed to encourage employers to hire, supervise and train individuals with specific needs. This assistance can cover wages, training or the purchase of equipment or modifications to accommodation. For example, the Australian Government provides a wide range of subsidies to employers hiring

\textsuperscript{268} Although this scheme is due to be replaced in January 2014 with a ‘subsidy for practical learning’ scheme.


\textsuperscript{270} Local Area Labour Markets in Scotland 2012, http://www.scotland.gov.uk/Publications/2013/05/6728.
workers falling into certain categories, such as disabled workers or those with limited work experience.\textsuperscript{271}

- \textit{Taxation} – such as tax allowances, credits, or exemptions (for example, through employer social security contributions). The Work Opportunity Credit in the US incentivises employers to recruit individuals facing barriers to employment by reducing employer tax liabilities.\textsuperscript{272}

- \textit{Training and Support Services} – employability services to help prepare recipients for employment. Pre-employment services can include training in basic and technical skills, as well as appropriate work behaviour. Supportive services can include help with transportation, childcare, and housing costs, substance abuse treatment, and continued education and training. For example, at a UK level, provision of ‘Workchoice’, the UK Government’s specialist programme to help disabled people enter the job market and support employers to recruit disabled people.\textsuperscript{273}

**Conclusion**

7.86 Scotland performs relatively strongly on headline labour market indicators.

7.87 There are though a number of notable challenges. These would not disappear automatically under independence, however, it would provide more of an opportunity to shape policy responses to the unique circumstances in Scotland.

7.88 Under the current framework, whilst the Scottish Government has responsibility for education and skills, key additional economic levers which can support the labour market, including employment regulation, employment services, taxation and welfare, are reserved to the UK Government.

7.89 As a result the benefits – such as tax and national insurance receipts and/or lower benefits payments - of Scottish Government action to improve labour market outcomes accrues to the UK Government.

\textsuperscript{271} http://deewr.gov.au/financial-assistance-employers
\textsuperscript{272} http://www.doleta.gov/business/incentives/opptax/eligible.cfm
\textsuperscript{273} https://www.gov.uk/work-choice
7.90 Whilst Scotland has had a stronger employment record than the UK, consistent with the trend at the UK level, the characteristics and composition of our labour market has changed in recent years with negative consequences for job security, the rewards to work and the equality of opportunity.

7.91 With access to the full set of levers, a more coherent framework could be created, which aligned the range of supply side policies – tax, welfare and skills – with demand policies and institutional frameworks in order to support people enter and remain in employment. The levers could also be used to support greater economic opportunity across Scotland’s potential workforce.

7.92 Future governments of an independent Scotland may wish to use these additional economic levers in a number of ways, for example –

- Build a strengthened social partnership approach which directly linked government, the third sector, unions, employer associations and employers;

- Taxation could be used to incentivise a range of actions such as increasing employer demand (for example through changes to employers National Insurance Contributions), encouraging firms to invest in training and development, and to improve labour market participation amongst certain groups;

- A single agency approach to employability could facilitate better alignment of services and coordination of skills and training programmes to deliver a more streamlined and efficient system;

- Develop a more integrated approach between welfare and other public services such as health, housing and social care;

- Scotland could have its own Employment Rights Authority bringing together employment-related matters under one body;

- Develop a distinctive Scottish approach to address underrepresentation and achieve a more balanced workforce; and,

- The process for increasing the minimum wage could be designed to reflect the circumstances of the Scottish economy, the business environment and the social and economic priorities of the people of Scotland.
Improving labour market outcomes is a key factor in reducing inequality and ensuring that economic growth results in shared and sustainable improvements for the whole population, this is discussed further in the next chapter.
Chapter 8: Ensuring that Growth is Shared and Sustainable

Chapter Summary

- There is now a growing consensus that the economic model adopted by many countries in recent decades was unsustainable and did not have a strong enough focus on long-term value creation.
- This has been particularly true of the UK, which is now one of the most unequal countries in the OECD and on many indicators is less resilient than competitors.
- Independence would provide Scotland with the opportunity to pursue a model which was focused on delivering fairer and more sustainable outcomes.
- Many of the challenges facing Scotland – in terms of the distribution of income and variations in regional outcomes – are long-standing. They will require prioritisation and careful policy design over a number of years.
- Independence would provide an opportunity to systematically and purposefully design policy to support growth under the principles of fairness, equality and the empowerment of communities.
- Independence would also allow future Scottish governments to build on the progress being made in Scotland to tackle climate change, to capture the considerable opportunities in the low carbon sector and to deliver genuine sustainable economic growth in Scotland.

Introduction

8.1 It is becoming increasingly apparent that a focus purely on high level economic measures such as economic growth and average levels of employment and unemployment as the sole objectives of economic progress is no longer appropriate.

8.2 Economic progress that is shared more equally across society and geography, which is more resilient to unexpected shocks and which is more environmentally sustainable, is just as important. A wider metric of measures and policy approaches is therefore required.

8.3 In this chapter, ensuring growth is shared and sustainable is looked at in terms of –
- Income equalities;
• Regional equalities; and,
• Sustainability.

8.4 As highlighted in Chapters 2 and 3, independence would offer the opportunity to move away from the current economic model which has led to the UK becoming one of the most unequal societies in the OECD – and pursue a new economic model with a stronger focus on long-term value creation Box 8.1.

Box 8.1: Case Study: Relationship between Government, Employers and Employees

The Scottish Government’s Council of Economic Advisers is undertaking work to identify potential opportunities for Scotland to develop and promote a model of ‘Responsible Capitalism’. This would encapsulate all policy levers, and critically the design of institutions and international representation.

In their initial work,274 the Council stressed the importance of genuine long-term economic value rather than short-term gain (for example, consideration of diverse issues such as bonus payments, infrastructure investment, employment regulation, procurement and sustainability) and of taking account of a wide range of economic, social and environmental metrics (such as an outcomes based approach and a focus on prevention). At the same time, governance and institutional design could better maximise community and local involvement.

This has the potential to be beneficial not just in terms of specific issues relating to equality and the environment but there is also a growing body of evidence demonstrating that embracing sustainability is also good for long-term growth.275

Scotland is already making progress through initiatives such as the National Performance Framework.276 With independence, there would be greater scope to build on this and to take such an approach to all aspects of policymaking and exploit synergies between current devolved and reserved powers.

276 http://www.scotland.gov.uk/About/Performance/purposestratobjs
8.5 It would also provide an opportunity to build a more robust and resilient economy that was focussed on genuine value added and not on speculative asset price bubbles or the concentration of economic activity in one particular part of the country.

8.6 It would also allow Scotland to choose an economic model that reflected Scotland’s unique natural environment and which took advantage of the country’s potential to lead the transformation to a low carbon economy.

**Scotland’s Current Performance in Delivering Shared and Sustainable Growth**

**Social Equity**

8.7 Although levels of income inequality and poverty are lower in Scotland relative to the UK, greater levels of income equality are found in many internationally comparable countries.

8.8 Scotland’s Gini coefficient has been lower than the UK in each year over the period 1994/95 to 2011/12. However, there has been little progress in reducing inequality in Scotland over this time – Figure 8.1.
Debates regarding levels of inequality often solely focus on welfare and taxation. While important, a key avenue to tackling income inequality is the provision of greater employment opportunities and appropriate rewards to work – Figure 8.2. For those groups facing additional barriers to employment, for example lone parents and people with disabilities, the barriers need to be removed to enable these groups to take up employment opportunities.

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Figure 8.1: Gini Coefficient Scotland, Great Britain/United Kingdom

Figures are for the United Kingdom from 2002/03 onwards. Earlier years are for Great Britain only. Thin lines show 95% Confidence Intervals.

Source: DWP Family Resources
Regional Equity

8.10 Outcomes and performance vary across Scotland - for example there are substantial differences in employment rates by local authorities.\textsuperscript{279}

8.11 Some of these regional disparities reflect a mixture of economic events and, often, decisions made by policymakers – for example, the management of the decline of industry and manufacturing in the 1980s.

8.12 These variations in economic performance have contributed to concentrations of deprivation across Scotland.

8.13 For example, in Glasgow, 42% of data-zones – a geographical unit used to measure performance in small areas – were in the 15% most deprived data-zones in Scotland.\textsuperscript{280}

\textsuperscript{279} Certain family types are over represented in the lowest income deciles. For example, 49% of single parent households in Scotland are in the bottom three income deciles; as are 43% of single pensioner households, 33% of single adult households, 29% of couples with dependent children, 29% of couple pensioner households, and 15% of couples without dependent children.

\textsuperscript{280} As highlighted in Chapter 7.
8.14 These variations extend to a wide range of outcomes. For example, life expectancy at birth for males varies from 71.6 years in Glasgow to 79.4 in East Dunbartonshire,\(^{281}\) and for females 78 years in Glasgow to 82.7 in East Dunbartonshire.

8.15 Addressing such challenges will require effort and commitment over a sustained period of time. However, the Scottish Government believes that under the current framework these regional disparities are often ignored in policy thinking at the UK level and while recognised in Scotland, the lack of levers constrains opportunities to fully address such challenges in a joined-up and truly transformational way.

**Sustainable Growth**

8.16 Climate change is undoubtedly one of the most important challenges that all countries now face. It will have far-reaching consequences for the economy, lifestyles, and the natural environment.

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\(^{280}\) The Scottish Index of Multiple Deprivation (SIMD) identifies small areas – ‘datazones’ – of high concentrations of multiple deprivation based on 38 different indicators covering a range of dimensions: Income, Employment, Health, Education, Housing, Access to Services and Crime.

\(^{281}\) Data for the period 2008-2010. Source: ONS
8.17 Failure to appreciate the likely implications, or to take decisive early action, is a threat not just to the environment but also the long-term success of the Scottish economy.

8.18 The Scottish Parliament has set Scotland ambitious targets to reduce greenhouse gas emissions – working towards a 42% reduction in emissions by 2020 and an 80% reduction by 2050.\(^{282}\)

8.19 Actions by the Scottish Government across a number of areas is helping to reduce emissions. For example, renewable energy has substantially increased its share of electricity generation – with the number of gigawatt hours generated by renewable sources increasing by 176% between 2000 and 2011.

**Figure 8.4: Electricity Generation by Source, 2000 to 2011\(^ {283,284}\)**

8.20 The transition towards a low carbon economy presents an economic opportunity.

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\(^{282}\) Reductions are against baselines from 1990 and 1995.

\(^{283}\) Source: Scottish Government Analysis and Department for Energy and Climate Change http://www.scotland.gov.uk/Publications/2013/08/1634

\(^{284}\) Notes:

1. Includes wind, wave, solar power, thermal renewables and hydroelectric (natural flow); and
2. Pumped storage is not a renewable source of energy because it uses electricity produced by other means to create a store of hydrological power.
8.21 Linking Scotland’s comparative advantage in terms of natural resources with its academic and engineering expertise has the potential to deliver significant benefits for the country’s long-term economic future.

8.22 The growth and development of a low carbon sector has the potential to create thousands of jobs and to export technology across the world. At the same time, a shift to a more efficient use of resources and the adoption of more sustainable practices will boost Scotland’s relative productivity and competitiveness.

8.23 As part of the transition to a low carbon and sustainable economy Scotland will need a mixed energy portfolio to provide secure and affordable heat and electricity for decades to come. In this regard, the substantial oil and gas reserves in the North Sea are a valuable resource. Box 8.2 provides details on quantifying its value.

<table>
<thead>
<tr>
<th>Box 8.2: Quantifying the Value of Remaining North Sea Oil and Gas Reserves</th>
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</table>
| North Sea oil and gas is a valuable resource that supports employment across Scotland and generates substantial tax revenues. It is the largest industrial sector in the Scottish economy. Oil and Gas UK’s estimate that there are up to 24 billion recoverable barrels of oil equivalent (boe) remaining in the North Sea.\(^{285}\) The Scottish Government estimate that these reserves have a potential wholesale value of up to £1.5 trillion, based on a range of robust assumptions\(^{286}\). The development and extraction of remaining North Sea oil and gas reserves will require significant investment by the industry. However, this investment - which includes capital and operating costs – will bring substantial economic benefits and generate tax revenue for the government. Therefore, the wholesale value of remaining reserves provides a complete picture of the total value of potential North Sea production and the investment by the industry and the economic benefits that this activity generates. The Office for National Statistics (ONS) publish a methodology for valuing remaining North

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\(^{285}\) Oil and Gas UK, 2013 Economic Report, http://www.oilandgasuk.co.uk/2013-economic-report.cfm, Oil and Gas UK also estimate that around one third of remaining reserves are gas and two thirds are oil.

Sea oil and gas reserves based upon a Net Present Value (NPV) estimate of Proven and Probable oil and gas reserves. This is a subset of total recoverable reserves and is currently estimated to be around 10 billion boe. The ONS methodology subtracts extraction, operating and decommissioning costs and discounts future benefits at the social discount rate. Based on this methodology this subset of reserves has a NPV of around £120 billion.

This type of financial accounting is important for informing decisions to license extraction of natural resources between competing projects or where there is an opportunity cost in terms of the use of resources. However, as expenditure is treated as an economic cost in this methodology, this figure does not provide an indication of the overall economic value of the North Sea and the benefits that will flow from the record levels of investment that are currently being observed.

These two approaches both have their merits depending upon the issue being analysed and should be viewed therefore as measuring different things.

8.24 As Box 8.2 highlights, the remaining value of North Sea oil and gas reserves is substantial. A recently published interim report identifies that a key challenge will be maximising the economic recovery from the North Sea. The review’s interim report was critical of the approach of past UK Governments to the oil and gas fiscal regime; stating that “fiscal instability has been a significant factor in basin under-performance”.

8.25 The interim report outlined a number of recommendations including committing to a new strategy to maximise economic recovery from the Continental Shelf and creating a new arm’s length regulatory body with additional powers. It stated that full and rapid implementation of the recommendations could deliver at least an additional 3-4 billion barrels of oil equivalent (boe) over the next 20 years, bringing over £200 billion additional value to the UK economy. Recent announcements, such as in the Kraken field, demonstrate the high levels of investment that are now flowing into the North Sea oil and gas industry providing significant economic opportunities for Scotland for years to come.

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Opportunities to Support Sustainability in an Independent Scotland

8.26 Delivering sustainable and inclusive outcomes will be an important principle for future Scottish governments.

8.27 In this regard, there is a clear disconnect between the approach taken in Westminster – particularly by the current coalition government – and that of successive administrations in Scotland.

**Box 8.3: Scottish Government Actions to Deliver Shared and Sustainable Growth**

The Scottish Government is pursuing a range of actions aimed at delivering better outcomes for all across Scotland:

- Shift to preventative prioritisation of resources;
- Increasing the amount and flexibility of early learning and childcare;
- Supporting and strengthening the role of the third sector;
- Prioritising investment in the first years of life – where actions have the greatest impact;
- The Social Wage (i.e. prescription charges, council tax freeze, concessionary travel) – in sharp contrast to the UK Government’s austerity programme;
- Protecting the pay of the lowest earners via the Scottish Living Wage; and
- Reflecting the importance of geography and place in initiatives such as the Agenda for Cities, Regeneration Strategy and creation of Enterprise Areas.

At the same time, the government is taking forward initiatives to tackle climate change. This includes the 2009 Climate Change (Scotland) Act and the associated reporting and regulatory requirements alongside specific policy initiatives such as –

- Supporting investment in renewable energy – e.g. £103 million Renewable Energy Investment Fund (REIF) and £70 million National Renewables Infrastructure Fund;
- Supporting the development of skills for future low carbon growth opportunities including Energy Skills Challenge Fund and Low Carbon Skills Fund;
- Active promotion – via Scottish Development International (SDI) – of Scotland’s low carbon economy in international markets; and
- Action to improve Energy Efficiency and deliver a 12% reduction in final energy consumption by 2020.
8.28 The impact of many policy actions will vary across groups and regions. Each policy action needs to be considered within the context of the overall policy mix.

8.29 This allows for the development of an overall policy framework which accounts for, and balances trade-offs.

8.30 Providing such a framework is only possible by having responsibility for the full set of economic levers provided by independence.

### Delivering Fairer Outcome Across Scotland

8.31 The inequalities in Scotland’s economy and society are long-standing requiring a careful prioritisation of resources.

8.32 Independence would provide an opportunity to systematically and purposefully tailor policy and the development of the Scottish economy to deliver sustainable economic growth alongside fairness, equality and the empowerment of communities. For example, one potential barrier to female employment is access to affordable – and good quality – child care. Under the current framework the Scottish Government only has limited opportunities to address this, and critically, the ability to afford policies – through for example re-investing savings from reduced welfare payments and higher tax revenues – is limited by the lack of fiscal autonomy (Box 8.4).

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**Box 8.4: Case Study: Opportunities in Childcare**

The cost and provision of childcare is highly correlated with female participation rates. The UK does not perform well on international comparisons of affordability, with childcare costs as a share of family income being the second highest in the OECD.²⁸⁹

There has been a significant change in women’s labour market participation in Scotland over the last 50 years. In the early 1960s, around 45 per cent of women were in paid employment, whereas in 2013, it was 69.5%.²⁹⁰ However, there are sharp divergences

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according to dependent child conditions in female employment rates according to whether they have children and the ages of their children – Figure 8.5.

**Figure 8.5: Employment Rate by Age of Youngest Dependent Child, 2012**

Employment levels for females with pre-school age children are lower in Scotland than in many other countries – including Scandinavia, the Netherlands and France.\(^{291}\) A variety of reasons account for such different participation rates. However, the cost and availability of childcare is often a barrier to participation in the labour market.\(^{292}\)

Sweden provides near universal provision, which is predominately publically funded, and there is a legal entitlement to childcare for all children aged one to school age.\(^{293}\)

Under the current system, the Scottish Government provides 475 hours of free pre-school education per year for three and four-year-olds in Scotland, and has already committed, through the Children and Young People (Scotland) Bill, to extending this to 600 hours for all three and four-year-olds and two year olds who are looked after or under a kinship care order. This is estimated to save a family up to £707 per year in costs.


\(^{292}\) For instance, see the findings of the commission on childcare for the Scottish Government and STUC’s 2012 Women’s Employment Summit (http://www.employabilityinscotland.com/media/218392/early_learning_and_childcare_-_women_s_employment_summit_-_report_of_key_points.pdf).

\(^{293}\) http://www.scotland.gov.uk/Publications/2013/03/4564/7
Responsibility for the levers which can influence childcare provision is split between the Scottish and UK Governments. For example, whilst the Scottish Government has responsibility for determining the level of funded pre-school entitlement, support for paying for childcare is also available through UK Government schemes in the form of either tax credits (the childcare element of Working Tax Credit) or childcare vouchers from employers which are exempt from tax and NI contributions.

Independence would bring with it an opportunity to fundamentally change childcare policy. A transformational shift towards a system of high quality, flexible, early learning and childcare supporting those who want to work to enter or remain in employment, will be challenging but achievable. It will provide an opportunity to invest more in the supply of services, rather than subsidising demand. This is the approach adopted in countries with the best and most inclusive outcomes for females in the labour market and will ensure resources are spent most effectively, and make childcare more affordable.

The Council of Economic Advisers has been examining the economic and social implications of such a shift in the childcare system. Advice to the Government will be provided in due course.

8.33 Childcare is just one issue that Scotland could take a new approach to with the powers and resources of independence. More generally, independence would provide the opportunity to develop a welfare system that better suited Scotland’s distinct economy.

8.34 As discussed in Chapter 4, only with independence would there be the opportunity to develop a tax and welfare system that would be consistent with Scotland’s specific needs, and the preferences of its citizens. It would provide the opportunity to consider how inequalities were to be tackled in Scotland through the tax and welfare system but also through improved alignment of wider public services (including existing devolved powers).

8.35 For example, under independence Scotland would have the opportunity to reform welfare more compassionately and to link such policies to health, housing and social care. In this way, the objective would be to provide a more personalised and joined-up package of support than at present. This would not necessarily be about spending more resources but of greater alignment and better use of existing spend.

8.36 Within the current framework the Scottish Government has adopted an approach based on preventative spend, focusing on preventing problems by intervening earlier. Independence would provide greater opportunities to establish a coherent framework
allowing welfare, taxation, employability, education and wider support services to be aligned and support the objective of preventative spending. A package of support could be provided for those who are able to work as well for those who are unable to work. The support provided would reflect the values of the people of Scotland.

Maximising the Potential of all parts of Scotland

8.37 Scotland’s economic competitiveness depends on making the most of its natural, economic and human assets.

8.38 These are distributed across Scotland. Many parts of the country however, face their own particular challenges and opportunities.

8.39 The rural economy is a significant part of the Scottish economy. It is intrinsic to Scotland’s identity, and appeal as a visitor destination.

8.40 Capitalising on Scotland’s natural assets underpins the growth of a thriving rural economy, and the industries of tourism, farming, fishing and food and drink, as well as new opportunities in renewable energy.

8.41 In reality, the performance of sectors such as agriculture and fishing are closely linked to decisions made by the EU. As discussed in Chapter 9, independence would give Scotland its own voice in Europe and more opportunity to reflect the interests of Scotland’s rural communities and associated industries. Under the current framework, where the UK Government’s negotiating position is based on interests at a UK level, there is no guarantee that Scotland’s national interests will be reflected.

8.42 Under independence, Scotland’s farming industry will also enjoy national status within the EU, opening up the opportunity to secure a fairer funding deal to support this important part of the Scottish economy and further enhance and protect Scotland’s rural environment.

8.43 Some remote rural communities contend with particular challenges such as geography, the importance of micro-businesses and self-employment, greater seasonality in economic activity and in some cases a high dependence on a small numbers of employers.
8.44 Independence would provide the opportunity for future Scottish governments to shape the regulation and operation of important services, including high-speed broadband and postal services to ensure that rural communities and businesses get a fairer deal rather than being penalised simply because of their location.

8.45 For example, the Scottish Government argued for a long-time for a derogation to be implemented to allow – subject to EU permission – a lower rate of fuel duty to be set in rural communities.\(^{294}\) Despite repeated representations to successive UK governments it was not until 2012 before a lower rate of fuel duty was finally set in a small number of communities in Scotland.\(^{295}\)

8.46 Scotland’s cities and urban areas will also be in line to benefit from independence, from an increase in economic activity in key areas such as manufacturing and high value services.

8.47 The Scottish Government believes that this delay and limited nature of the proposal provides a further example of key priorities in Scotland not being acted upon quickly by the UK Government and where issues that are disproportionately important for Scotland are not high enough up the agenda of the UK Government.

8.48 Other parts of the country face different challenges with some less well placed to immediately take advantage of growth sectors – and areas of Scottish comparative advantage – identified throughout this report. In these cases, a broader approach is required. For example some areas are particularly well placed to benefit from sectors such as health, education and utilities (for example foundational economies) and appropriate policies to support the spatial concentration of such activities can lead to more sustainable and balanced levels of growth at the national level.

8.49 Independence would offer scope for future Scottish governments to coordinate, for example, welfare, employability and job creating investment to yield better outcomes in particular local areas. At the heart of this, could be an alignment of local, regional and national priorities through effective partnership.

\(^{294}\) While relatively small in value both financially and environmentally given the number of people affected, such a regional policy would have a disproportionate positive impact on the local economy.\(^{295}\) [http://www.hmrc.gov.uk/thelibrary/tiin-rural-fuel-duty.pdf](http://www.hmrc.gov.uk/thelibrary/tiin-rural-fuel-duty.pdf)
Under independence, future Scottish governments would have full responsibility for transport, in contrast to the current split responsibilities.

This would allow for a genuinely integrated transport system to link urban and rural Scotland. A connected Scotland is also about connections to the international community.

To achieve an integrated transport system, the Scottish Government believes that the key levers of power and decision making should themselves be integrated.

It is difficult to fully achieve this under the current framework. Significant areas of transport are devolved, but key determinants such as the level of capital investment (for example via responsible borrowing) are often not. Many interdependencies, such as links to energy policy, are also reserved. At the same time, planned infrastructure projects in England, such as HS2 between London, Birmingham and on to Manchester and Leeds, do not extend to Scotland, despite a strong business case from a network that includes Scotland.\(^{296}\)

Moreover, in certain areas – such as rail – while activities are directed from Scotland, the framework in which the Scottish Government can operate is restricted. For example, full control over rail policy and regulation would allow for better integration between track and train to deliver more efficient and integrated services.

As discussed in greater detail in Chapter 9, the ability to reduce Air Passenger Duty would allow Scotland to better compete for direct international air links.

An independent Scotland would also have the opportunity to give greater priority to the shape of services that look after the safety of mariners and marine environment and develop to the fullest Scotland’s potential in maritime transport.

An issue of considerable importance for many communities is the provision of basic core national infrastructure. Again this is an area where the different structures of Scotland and the UK mean that the optimal policy for one could quite reasonably differ.

This is particularly true in the context of universal service obligations. These ensure that areas that may not be seen as commercially attractive receive a common level of

service. An important topical example is the universal postal service provided by Royal Mail and the Post Office network (Box 8.6).

<table>
<thead>
<tr>
<th>Box 8.6: Post Offices and Postal Services in an Independent Scotland</th>
</tr>
</thead>
<tbody>
<tr>
<td>There are two main postal services: the services offered by Post Office Limited through crown post offices and sub-postmasters and the services offered by Royal Mail.</td>
</tr>
<tr>
<td>The UK Government has chosen to separate the post office network from Royal Mail and subsequently to privatise the Royal Mail. The decision to privatise was taken despite strong opposition from the Scottish Government and the majority of Scottish MPs. A key concern, not only with the privatisation of a valuable state asset, is that this could threaten the quality of service and risk further increasing the price of postage. It also risks the long term future of post offices if Royal Mail chooses not to renew the inter-business agreement with Post Office Ltd. once the current contract expires in 2022. Such developments would have a disproportionate impact on Scotland’s rural and deprived communities.</td>
</tr>
<tr>
<td>Under independence the Government of Scotland would be able to consider the position of the Royal Mail in Scotland. The current Scottish Government has stated that, on independence, it is its intention to begin the process of bringing the Royal Mail in Scotland back into public ownership. Independence will also allow post office services to focus on what is best for communities and businesses, including enhancing the link between a publicly owned Royal Mail and post offices. In addition, responsibility for regulating postal services will transfer from Ofcom to a Scottish regulator, providing the opportunity to ensure a universal postal service is in place which suits Scotland’s needs, in particular the needs of remote and rural communities.</td>
</tr>
</tbody>
</table>

Capturing Opportunities from the Low Carbon Economy

8.52 Climate change policy is effectively already devolved as it was not explicitly reserved to the UK Government under the Scotland Act. However, while the Scottish Government and the Scottish Parliament have some autonomy in areas such as emissions targets, many of the policy levers required to help achieve the required transformational change are reserved to the UK.

8.53 As highlighted in Chapter 2, Scotland is however, making progress in delivering on its low carbon ambitions.
8.54 The low carbon sector presents considerable opportunities for growth, and future Scottish governments could prioritise economic policies – such as investment, taxation and trade policies – to set the conditions for the sector to succeed.

8.55 A key challenge is to help build the capabilities of firms operating in low carbon markets, enabling them to grow and internationalise, while creating greater critical mass.

**Box 8.7: Case Study: Growth Opportunities in the Low Carbon Sector**

The transition towards a low carbon economy offers significant potential for Scotland. In particular the opportunity to re-industrialise Scotland through green technology and engineering and to capitalise on the nation’s substantial natural assets.

The estimated market value of sales in the low carbon and environmental goods and services sector (LCEGS) in Scotland in 2011/12 was £10.1 billion, with around 4,200 companies employing around 78,000 people.

Sales have increased by 5% over the year from 2010/11 and by around 20% since 2007/8 (when data was first collected).

Scotland’s overall market value is forecast to grow by 30% from £10.1 billion to £13.2 billion between 2011/12 to 2016/17.297

International markets will be an important driver of future growth. Scotland’s LCEGS exports outside the UK were £987 million in 2011/12 or just under 10% of total sales.

Global LCEGS sales in 2011/12 are estimated at £3.4 trillion, up 3.8% over the last year. Global sales are forecast to grow at an annual rate of between 4.0% and 4.2% up to 2015/16.

It is not just in the specific low carbon sector where there is potential. Scottish firms – across the economy – have an opportunity to reduce their costs and increase productivity by improving their resource efficiency. This can be particularly beneficial given recent volatility in global commodity prices.

For example, DEFRA estimate that UK businesses could save around £23 billion per year from simple resource efficiency measures.298

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297 Applying UK wide LCEGS growth forecasts (between 2011/12 and 2015/16) from the BIS data to the overall Scottish LCEGS sales figures.
Scotland arguably has a particularly unique opportunity to capture a potential ‘double dividend’ of stimulating economic activity whilst lowering emissions.

8.56 An independent Scotland would have a greater platform on which to demonstrate international leadership on climate change. For example, future Scottish governments would have a direct voice in the UN and EU (UNFCCC), the EU Environment Council, and Agriculture and Fisheries negotiations, providing greater scope to influence the transition to a low carbon economy.

8.57 Independence would also allow Scotland to have direct involvement in the development and adoption of international climate change regulatory frameworks, which are a significant driver of international demand for low carbon and environmental sales. The EU ETS for example, is a major determinant of climate change policy in EU Member States.

8.58 There is also a market opportunity in advising governments and public agencies on the design and implementation of such frameworks which an independent Scotland could provide leadership in. Climate justice is a key area where Scotland is at the forefront of the fight against climate change, developing a fund will help reduce the impact of climate change on the world’s poorest communities.

8.59 Closer to home, full legislative and regulatory powers would enable a much greater focus on energy efficiency measures and tackling fuel poverty appropriate for Scottish customers.

8.60 For instance, following independence, the government could transfer responsibility for energy efficiency measures which currently sit with energy companies to the Scottish Government, and meet the costs from general taxation.

8.61 Other independent countries have pursued a range of taxes and financial incentives aimed at delivering environmental and sustainability objectives – Box 8.8. They have often done so via a more efficient and simplified system.

299 United Nations Framework Convention on Climate Change
300 http://www.scotland.gov.uk/Topics/Environment/climatechange/climatejusticefund
8.62 With independence future Scottish governments could consider – for the same amount of tax collected – the relative tax burden between items that are valued positively by society (e.g. jobs, incomes) vis-à-vis those that are valued negatively (e.g. pollution). To the extent that if values and strengths of priorities were to differ in Scotland compared to those in the UK as a whole, there could be scope to take a different path.

**Box 8.8: Case Study: Environmental Taxation across the OECD**

A range of environmental policy tools are available, including regulation, taxation, tradable permits, negotiated agreements, and subsidies.

The OECD highlight that, “Although no single instrument can be considered best to address every environmental challenge, there has been a growing movement towards environmentally related taxation (and tradable permits) in OECD economies.”  

The majority of revenues from environmental taxes are from energy – in particular transport. Despite a widening of the base for environmental taxes, the OECD highlight that revenues had gradually decreased over the past decade relative to both GDP and total tax revenues, driven by price increases stemming the demand for fuel and a decline in real rates of fuel taxes.

**Motor Fuel**

- Most countries have taxes on both petrol and diesel.  
- As a percentage of pump price the UK had the highest tax component of diesel prices (57% of pump price) and the second highest tax component of unleaded petrol prices (59% of pump price) of the 28 EU countries in September 2013.

**Vehicles**

- Taxes on motor vehicles make up a large proportion of total environmental tax revenues – these can be one-off (i.e. levied on the initial purchase) or recurrent (i.e. an annual tax).
- Such charges are increasingly based on environmentally relevant characteristics such as fuel efficiency, CO2 emissions, engine size and weight.

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302 http://www2.oecd.org/ecoinst/queries/TaxRateInfo.htm
Other Taxes

- Denmark has a wide range of environmental taxes, including duties on plastic bags, disposable cutlery, electric bulbs and phosphorous in animal feed.
- An increasing number of countries have levied taxes on areas such as energy consumption, waste, batteries, solvents, the use of pesticides and fertilisers and landfill.

8.63 The transition towards a low carbon economy presents both a challenge and tremendous opportunity for Scotland. It will require some tough choices and a commitment to potentially put off some popular short-term policy decisions in favour of a more stable and long-term commitment to improving economic resilience and environmental sustainability. This will pay dividends.

8.64 Finally, independence would provide Scotland with full responsibility for its natural assets. There has been extensive discussion over Scotland’s oil wealth.

8.65 However, it is just as important in other areas. For example, Scotland has over 60% of the UK’s sea area and almost 470,000 square kilometres of sea – six times the land mass\(^{304}\). All of Scotland’s sea bed, most of Scotland’s foreshore and some other public assets are currently managed by a body that is not accountable to the Scottish Parliament: the Crown Estate Commissioners (CEC). The revenues from their management flow out of Scotland to HM Treasury.

8.66 Despite there being widespread support for greater accountability and the return of these rights to Scotland, successive UK governments have refused to devolve these powers. The Scottish Government has long argued that responsibility for the Crown Estate would bring greater accountability and more efficient administration, better use of the substantial revenues that it generates through various licensing rights and more efficient and effective management of Scotland’s precious natural resources.\(^{305}\) The Scottish Government is also in discussion with Scotland’s island authorities on ways in which they can share in the benefits from the natural resources around them.


Conclusion

8.67 Economic progress that is shared more equally across society and geography, which is more resilient to unexpected shocks and which is more environmentally sustainable, is vitally important.

8.68 In an independent Scotland policy design could better reflect the principles of the people of Scotland and focus on delivering fairer and more sustainable outcomes. While Scotland has some of the powers to deliver growth that is more equal and sustainable it lacks the full range of policy levers and the ability to exploit synergies between all aspects of policy.

8.69 With independence, an independent Scotland could take forward –

- Policies to knock-down barriers to employment and fulfilling economic potential such as the delivery of a more effective system of childcare;

- Developing a tax and welfare system suited to Scotland’s needs which supported those who are able to work into valued and rewarded employment and at the same time offered support to those who are unable to work in a way which better reflected the values of the people of Scotland;

- Fully developing connectivity across Scotland including transport and telecommunications;

- Directing involvement in the development and adoption of international climate change regulatory frameworks, which are a significant driver of international demand for low carbon and environmental sales; and

- Using the full range of tax and regulatory powers to help take advantage of Scotland’s comparative advantage in the low carbon economy. Shape behaviours to deliver on Scotland’s sustainability and climate change objectives and better manage the nation’s natural resources.

8.70 The final aspect of the opportunities under independence is Scotland’s role in the international community. This is discussed in the next chapter.
Chapter 9: Scotland’s Position in a Globally Integrated Economy

Chapter Summary

- At the heart of any economic framework in the modern global economy is the international context in which it operates.

- Global integration creates challenges and opportunities for all economies. However, many countries of similar size to Scotland have been particularly successful in their ability to capture new international opportunities for growth.

- Scotland has an established network of global connections and international reputation. It lacks however, the presence of an independent nation on the global economic stage.

- Boosting Scotland’s export base has the potential to have significant benefits across the Scottish economy.

- As an independent sovereign state Scotland would have the freedom to strengthen existing, and establish new, relationships with the international economic community.

- Post-independence, Scotland would remain a member of the European Union. This would ensure that businesses continued to operate in a Single Market with, not just the UK, but the 500 million customers of the EU.

Introduction

9.1 Scotland is an open and globally integrated economy.

9.2 In the most recent Anholt-GfK Roper Nation Brands Index (NBI), Scotland was ranked 15th out of 50 nations in 2012 in terms of global recognition. Scotland is ranked similar to, and often ahead of, a number of independent smaller high income countries (including Denmark, Finland, Ireland and New Zealand).306

9.3 In 2011 Scottish firms export nearly £24 billion of goods and services to economies across the world, and around £45.5 billion to the rest of the UK.

9.4 Scotland has a long tradition of out-migration, but also in-migration. International movement is increasing, supported by greater freedom of travel and work provided through for example, membership of the EU.

9.5 Independence would allow Scotland to take its place as an independent state on the global stage.

9.6 This would enable Scotland to strengthen, and establish new, relationships with the international economic community. This would be a significant boost to the ‘Scottish brand’. Brand identity and reputation in the global economy is of enormous benefit and significance.

9.7 At the same time, Scotland would gain the authority to shape and influence policy at the international level. Access to the points of decision-making power would increase significantly allowing Scottish ideas and insights to be more effectively communicated.

9.8 This final chapter examines a range of issues relevant to Scotland’s position in a globally integrated economy including –

- Scotland’s Trade Activity;
- Attracting International Investment; and,
- Attracting New Workers

**Scotland’s Links to the Global Economy**

**Scotland’s Trade Activity**

9.9 Scotland is globally connected with trade links across the world.

9.10 International exports are however, currently heavily concentrated in ‘traditional’ markets such as the EU and North America. Together they accounted for around 62% of Scotland’s international exports in 2011. Moreover in the same year, 20 destinations accounted for nearly 75% of international exports. This increases to 91% when exports to the rest of the UK are included.
### Table 9.1: Top 20 Destinations for International Exports, 2011

<table>
<thead>
<tr>
<th>Rank</th>
<th>Destination</th>
<th>Exports (£m)</th>
<th>Rank</th>
<th>Destination</th>
<th>Exports (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>USA</td>
<td>3,525</td>
<td>11</td>
<td>Singapore</td>
<td>455</td>
</tr>
<tr>
<td>2</td>
<td>Netherlands</td>
<td>2,665</td>
<td>12</td>
<td>Sweden</td>
<td>450</td>
</tr>
<tr>
<td>3</td>
<td>France</td>
<td>1,935</td>
<td>13</td>
<td>Brazil</td>
<td>435</td>
</tr>
<tr>
<td>4</td>
<td>Germany</td>
<td>1,365</td>
<td>14</td>
<td>China</td>
<td>400</td>
</tr>
<tr>
<td>5</td>
<td>Belgium</td>
<td>980</td>
<td>15</td>
<td>UAE</td>
<td>380</td>
</tr>
<tr>
<td>6</td>
<td>Eire</td>
<td>780</td>
<td>16</td>
<td>Japan</td>
<td>365</td>
</tr>
<tr>
<td>7</td>
<td>Norway</td>
<td>765</td>
<td>17</td>
<td>Other Africa</td>
<td>345</td>
</tr>
<tr>
<td>8</td>
<td>Spain</td>
<td>710</td>
<td>18</td>
<td>Canada</td>
<td>325</td>
</tr>
<tr>
<td>9</td>
<td>Switzerland</td>
<td>640</td>
<td>19</td>
<td>Denmark</td>
<td>325</td>
</tr>
<tr>
<td>10</td>
<td>Italy</td>
<td>610</td>
<td>20</td>
<td>Australia</td>
<td>320</td>
</tr>
</tbody>
</table>

Source: Global Connections Survey

**Key Fact:** Over 91% of total Scottish international exports go to just 21 destinations.

9.11 At the same time, Scottish export activity is relatively concentrated both within certain sectors and a number of larger firms – Figure 9.1. There is also evidence that small firms in other European countries are more likely to export.

### Figure 9.1: Sector Shares of Scotland’s International Exports, Top 10 Sectors, 2011

![Sector Shares Chart]

Source: Scotland's Global Connections Survey

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307 Council of Economic Advisers: First Annual Chair’s Report 2013  
http://www.scotland.gov.uk/Publications/2013/03/3186

Globalisation is likely to further increase the scope for Scottish companies to benefit from trade. As part of the EU Single Market, and independent Scotland will retain an integrated market – not just with the UK – but with Europe. Moreover, as the global economy continues to expand, there is a need to look beyond traditional markets such as the UK – Box 9.1.

**Box 9.1: The UK Economy in a Global Context**

In 2012, the IMF estimated that the UK was the 8th largest economy in the world (2.8% of global GDP and 14.5% of EU GDP). With many other countries – including the US, Australia, Mexico and the BRIC countries – forecast to grow more rapidly than the UK over the coming years the UK’s share of global output will decline. This highlights the importance of a truly outward focussed approach to business growth and market development.

**Figure 9.2: 2012 GDP, $ Billion, PPP adjusted**

![GDP comparison chart](source)

- **United Kingdom**: $2,313
- **European Union**: $15,993
- **United States**: $16,245
- **World**: $83,193

Source: IMF World Economic Outlook Database, October 2013

Evidence suggests that trade not only increases market size but also encourages firms to be more innovative. Companies that are exposed to international competition can become more productive, with positive spill-overs to domestic supply chains and the creation of agglomeration effects.

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309 2012 GDP in purchasing-power-parity (PPP) IMF World Economic Outlook Database, October 2013
310 The BRIC countries are Brazil, Russia, India and China.
As part of the UK, Scotland has arguably underperformed in certain areas of internationalisation compared to peers (see Chapter 2 for a discussion of the UK’s export performance). Tackling this will be key to rebalancing and boosting long-term economic growth.

**Box 9.2: Analysis of the Impact of Boosting Exports**

As the pace of globalisation quickens, exports will make an increasingly vital contribution to Scotland’s economic future as an open economy.

There has been some improvement in recent years, with the value of Scottish international exports increasing by 7% between 2010 and 2011. The Scottish Government believes that with the ability to develop a uniquely Scottish approach to trade promotion, supported by a clear and coherent industrial strategy, an independent Scotland would be better placed to compete internationally. Greater export intensity can be achieved through well-directed supply-side policies and could expand the economy, increasing investment and boost employment.

The Scottish Government currently has a target of boosting the value of international exports by 50% by year 2017.

The impacts of such improvement in the export performance in the wider economy could be significant. As an illustration, achieving the 50% target, which is expected to be equivalent to a 31.6% increase in real terms (in 2010 prices) would boost Scottish output and increase employment, as well as raising additional tax revenues. In the long-run, the Scottish Government estimates that output could increase by 4.6% (around £5.6 billion) and employment by 4.5% (around 112,000). This is based on the assumption that the additional tax revenues that arise from increased exports do not feed into higher government expenditure (i.e. broadly similar to the status quo funding settlement).

The benefits to the Scottish economy from meeting the exports target can be amplified if the increases in revenues associated with it can be then be recycled back into the economy, which can be done under independence through higher government spending (i.e. maintaining the initial budget balance).
The Scottish Government estimates that, in the long-run, the increase in output and employment could be 8.6% (around £10.5 billion) and 9.0% (around 223,000) respectively. This reflects the impact of increased government expenditure which is projected to increase by £3.7 billion as a result of a larger tax intake.

**Figure 9.3: Impact on the Scottish Economy of a 50% Increase in Exports Value**

![Graph showing impact of 50% increase in exports value on output, employment, and other economic indicators.](image)

**Attracting International Investment**

9.15 International investment can play an important role in delivering growth and employment, and can also provide an indication of the underlying competitive strength of the economy.

9.16 Such investment boosts output and economic activity. In addition, it can also create spill-overs – for example, by improving productivity\(^{311}\) and leading to knowledge and innovation transfers to local firms.

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\(^{311}\) For example, analysis by Harris & Moffat (2013) finds that over the period 1997-2008, “…foreign-owned firms contributed relatively more to aggregate productivity growth than UK-owned plants over the period.” *The Contribution of FDI to Productivity Growth in Britain, 1997-2008*, Harris and Moffat, March 2013
9.17 Scotland has performed strongly in recent years in attracting international investment. The Ernst and Young UK Attractiveness Survey examines international investment flows.\textsuperscript{312} In 2012 Scotland had the largest share of any UK country or region outside London with 11% of all UK FDI projects, an increase of 49% compared to 2011.

9.18 However, a key challenge is ensuring that such investment develops strong linkages with the domestic economy – for example, through strengthened and new supply chains. Otherwise the resilience of the domestic economy to such investment can be limited. The decline of the electronic manufacturing cluster in Scotland in the early 2000s is a case in point.

### Attracting New Workers

9.19 Historically, Scotland has been a country of net emigration. There is a long history of talented young people moving out of Scotland because of a lack of economic opportunity.

9.20 However, in recent years Scotland has witnessed net migration gains. The latest population figures show that in 2011-12, 26,200 people emigrated from Scotland to the rest of the World, whilst 35,900 people migrated in the other direction.

9.21 Scotland’s largest migration flows are with the rest of the UK. In 2011-12, 45,100 people moved to Scotland from the rest of the UK, whilst 42,100 moved in the opposite direction.

There are estimated to be around 1 million Scots-born people who live outside Scotland – the Scottish Diaspora – and this has provided important resource to strengthen trade links and international engagement. The number of people with a Scottish affinity or ancestral link is much larger.

The ‘Global Scots’ network - which is made up of 650 leading Scottish business people and experts with an affinity for Scotland located throughout the world, and working in a wide range of industries at the very highest level - is an example of how this works in practice.

Attracting skilled – working age – migrants is vitally important and has been recognised by successive administrations in Scotland. They make a positive contribution to the economy as a whole but can also have a disproportionate benefit for key sectors. For example, Scotland’s universities gain significant advantages from attracting overseas...

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**Figure 9.4: Migration into and out of Scotland, 2001-02 to 2011-12**

![Graph showing migration into and out of Scotland (2001/02 to 2011/12)](http://www.gro-scotland.gov.uk/files2/stats/migration/overseas_mig_flows_by_age_scotland_2001-02_to_2011-12_updsept13.xls)

Source: National Records of Scotland

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313 National Records of Scotland *In, out and net migration by age group between Scotland and overseas, 2001/02 to most recent* http://www.gro-scotland.gov.uk/files2/stats/migration/overseas_mig_flows_by_age_scotland_2001-02_to_2011-12_updsept13.xls

students. It is estimated that overseas students contribute around £441 million per annum to the Scottish economy.\(^{315}\) Educating overseas students is also an excellent example of ‘soft-power’ as it provides an opportunity to build up links with future industrialists and business leaders from across the globe for decades to come.

9.25 However, as a result of different political motivations elsewhere in the UK, current reserved policy choices are serving to restrict the number of overseas students coming to Scotland.

**Taking Advantage of the Global Economy**

9.26 All open economies, regardless of size, face significant exposures to global economic conditions. These external forces can be both positive and negative, and how nations respond to them will have a significant bearing on their performance over time.

9.27 Recent research highlights how a number of smaller countries have been particularly successful in their approach to global integration and capturing new opportunities. This research suggests a number of reasons for this. Although there are different models for success, a consistent finding is that smaller countries “tend to adopt a more deliberate policy approach that is focused on competing in the global economy.”\(^{316}\) They also understand “that their economies need to be distinctive in some way.”

9.28 The global environment is complex and in order to successfully navigate it countries need to understand the opportunities, and implications, of emerging global trends; and develop productive relationships with the international economic community.

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Anticipating future global economic trends is important in shaping economic policy. This is less about short to medium term economic forecasting and more about the clear recognition of the future drivers of growth over the long-term. Key issues of relevance include –

- **A shift in global power** – with a growing importance of emerging markets whose future consumption patterns offer new opportunities.\(^{317}\)

- **Increased economic and political turbulence** – as the financial crisis highlighted, the increasingly networked and linked global economy brings – along with the potential for growth – an increased risk of shocks in one part of the global economic system spreading across national boundaries.\(^{318}\)

- **A changing multilateral system** – differences in the interests of the traditional economic powers and new emerging countries has the potential to make it more challenging to reach consensus on issues such as trade and climate change. Navigating these relationships will be important. Smaller countries have the potential to form strategic alliances and to use their size as an advantage.\(^{319}\)

Alongside these strategic challenges, a number of global trends will also exert influence including demographic change in advanced economies, greater scarcity of natural resources (including fuels, minerals and water), emerging technologies and increased mobility (both of labour and capital through the digital age).

9.29 The changing international environment has implications for the development of economic policy in Scotland.

9.30 As an independent nation, Scotland would have increased exposure to the opportunities created by the global economic system.

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\(^{317}\) Ernst and Young (2011) *Tracking Global Trends*  

\(^{318}\) International Monetary Fund (April 2013) *World Economic Outlook*,  

9.31 In particular this requires:

- A distinctive approach, built around a coherent vision of how an independent Scotland would compete in the competitive global economy.
- International integration and a structured approach to bilateral and multilateral engagement.
- A focus on resilience (both economically and socially) concerning the strategic direction of policy and the extent to which social and political institutions support a rapid adjustment to external shocks or identify and exploit new areas of opportunity.

**Opportunities to boost Scotland's International Economic Activity from Independence**

9.32 With access to the full set of policy responsibilities under independence, future Scottish governments would have the opportunity not only to set a direction based on a distinct Scottish approach, but also the opportunity to bring greater coherence to its international strategy.

**Box 9.4: Scottish Government Actions to Promote Internationalisation**

Within the powers currently available, the Scottish Government is taking forward a range of actions to boost Scotland's international trade and investment and to strengthen its voice internationally. Key actions include –

- Development of an overarching strategy that sets the context and rationale for the government’s international activities – including focussing on specific world regions and individual countries to identify and build cultural, economic and political links.
- An ‘Action Plan on European Engagement’, which takes a pragmatic approach to ensure activities are properly focussed for maximum impact in the EU.
- Growing the presence of Scottish Development International (SDI) to encourage Scottish companies to trade.
- Continuation of the Global Scot scheme that connects Scottish businesses with Scots worldwide to create an international business network.
- International promotion of Scotland and its tourism assets through VisitScotland.

Supporting the university sector in developing international relationships and promoting Scotland as an educational leader through collaborative research projects, trans-national education in campuses abroad and international partnerships.
9.33 Being prepared to consistently and confidently promote Scottish values whilst advancing and protecting Scotland’s national interests will be a key task for an independent Scotland.

9.34 Flexibility will be key. Smaller countries can be particularly adept at responding to shifting trends, whether in international politics, the global economy or the patterns of tourism across the world. Scotland, with the powers of independence, could look to follow a similar lead.

9.35 Independence would allow Scotland to organise its institutions and structures that support trade in a manner that reflected Scotland’s scale and international ambitions. A country the size of Scotland does not need the full range of separate departments and agencies of larger countries that can make decision-making bureaucratic, time-consuming and costly. A more efficient and joined up approach could deliver better value and generate more impact.

9.36 Independence would provide Scotland with the opportunity to fully utilise its “soft” power. This includes the ability to determine how it wants to build its national brand/reputation and use its cultural activities to promote itself externally. This will also be informed by an independent Scotland’s approach to foreign policy and international aid. Countries such as Ireland, New Zealand and Norway have used such powers of influence to good effect.

Scotland’s relationship with the international community

9.37 Post-independence Scotland would be able to strengthen, or establish new, relationships with key elements of the international economic community. Many of which are not currently open to Scotland.

9.38 An independent Scotland would maintain a close and constructive relationship with the rest of the UK and would seek to actively participate in the EU, UN and other major international organisations to advance its national interests and promote Scottish values.

9.39 A key factor in achieving success as an independent state will be Scotland’s participation in multilateral organisations, such as the EU, UN and WTO. Active engagement
in such fora will enable Scotland to promote and negotiate its interests within a clear rules based co-operative structure.

9.40 Scotland’s contribution to the EU, as an active and constructive Member State, will be a key aspect of Scotland’s role in the international community.

9.41 The EU is already an important partner in Scotland’s success. But Scotland lacks the representation, visibility and influence of an independent Member State. This holds Scotland back.

9.42 The current Scottish Government has set out its commitment to Europe.

9.43 Membership of the EU provides a range of economic benefits, in particular through access to the Single Market, the largest trading area in the world, with over 500 million potential customers.

9.44 The EU is estimated to benefit the UK economy ‘to the tune of between £31 and £92 billion a year. Between £1,200 and £3,500 for each and every family in the UK’.320

9.45 As an independent member of the EU, Scotland would also continue to benefit from the range of preferential trade deals, including many free trade deals, the EU has secured. For example, a trade deal is currently being negotiated with the United States, which the UK Government has estimated could be worth £100 billion to the EU economy, £80 billion to the US and £85 billion to the rest of the world, creating two million jobs, and leading to more choice and lower prices.321

9.46 As part of the UK, aspects of EU law and policy are already incorporated into the Scottish legislative and policy environment. However as an independent Member State it would fall to the Scottish Government to decide the appropriate legislation required to incorporate EU Directives into national law, taking account of local circumstances, in order to meet the objectives of the legislation

320 Speech by Michel Barnier, European Commissioner for Internal Market and Services, LSE 17/10/2013.
321 https://www.gov.uk/government/speeches/g8-summit-us-eu-trade-statement
Box 9.5: Examples of the Benefits of Scotland being an Independent Member of the EU

Under independence the Government of Scotland would represent Scotland’s interests as a full and equal partner in the EU system of governance.

As an independent member state, Scotland would have the opportunity to influence the development of the rules and regulations that support the efficient operation of the single market.

Under the current framework Scotland is represented by the UK at discussions on EU legislation. There is no guarantee that these interests are always aligned.

As a result the Scottish Government relies on intergovernmental relationships to ensure Scottish interests are represented. This can only be partially successful.

The EU system of governance is one in which legislative and policy outcomes are the result of a process of negotiation and discussion, and in which compromise is inevitable. It is not a system of governance whose outcomes are determined by the size of particular Member States.

The recent successes of the Irish and Danish Presidencies have highlighted how successful and influential small member states can be in influencing and shaping the policy agenda at a European level. For example, Ireland’s 2013 Presidency of the EU is widely credited with having focussed the efforts of the EU and its institutions on youth unemployment.

As an independent member of the EU the Scottish Government would be able to fully represent Scotland’s interests and priorities. This could lead to a number of significant benefits.

For example, under independence the Scottish Government would be better able to represent the interests of Scotland’s agricultural sector. When compared to EU Member States, Scotland currently receives the third lowest level of direct payments per hectare and the lowest level of EU Rural Development funding per hectare. The recent announcement by the UK Government on CAP funding allocations for 2014-20 confirmed that Scotland would be at the bottom of the EU per hectare league table in terms of both direct payments and Rural Development Funding in the years ahead.

If Scotland had been independent when the latest Common Agricultural Policy (CAP) budget was decided then Scotland would have benefitted from a rule that – by 2020 – no EU member state would receive less than an average of €196 per hectare in direct payments. It is estimated that this could have provided Scotland’s farmers with an additional €1 billion euros between 2014 and 2020.

9.47 The ambitions of the Scottish Government and the EU are closely aligned, and within the powers currently available, Scotland is making a substantive economic and social contribution to the range of challenges facing all European economies – from youth unemployment to climate change.

9.48 This is demonstrated by the alignment of the vision in Europe 2020 – the European Union’s strategy for delivering smart, sustainable and inclusive growth – and the Scottish Government’s Economic Strategy.323

9.49 However, as long as Scotland remains part of the UK it is possible that the current benefits of EU membership, and the future opportunities for growth, will be compromised.

9.50 Given the increasing likelihood that there will be a UK-wide referendum on EU membership in 2017, the UK Government has embarked on a path that may result in an increasingly marginalised role in key negotiations that will determine the future course of European integration. In the most serious case, any potential UK exit from the EU would have significant implications for Scottish businesses, growth and jobs.

9.51 An independent Scotland is therefore all the more vital to protect the benefits that the EU single market has provided to the Scottish economy and Scottish business.

Strengthening International Trade and Investment

9.52 As outlined above, openness to international markets is vital. It greatly expands the marketplace for Scottish companies and can help them innovate, adopt new technologies and seek out new opportunities. It builds confidence, ambition and leadership aspirations.

As highlighted in Box 9.3, over the longer-term, the greatest challenge and opportunity from trade will come from new and emerging economies. While their rapid growth has eroded competitiveness in certain areas, particularly sectors that rely upon cost, it also offers real potential in other areas such as knowledge intensive sectors.

Scotland already has a presence in some of these emerging markets, with Brazil and China amongst the current top 20 destinations for Scotland’s international exports; whilst Scottish Development International (SDI) currently have offices across Asia, the Pacific, Europe, the Middle East and the Americas.\(^\text{324}\)

An independent Scotland could prioritise efforts and resources towards strengthening its international presence in the nations of greatest economic importance. It could prioritise resources to key markets. As highlighted above, 91% of total Scottish exports are to 21 countries.

Scotland is already pursuing a successful Team Scotland approach and independence can help strengthen this. Independence allows Scotland to optimise policy coherence across both public, private and third sector actors. This move towards a more collaborative and aligned approach has been pursued by a number of successful small countries, including Finland (see Box 9.6), Singapore, and New Zealand.

### Box 9.6: Case Study: The Team Finland Approach

A ‘Team Finland’ network is now a key element of the Finnish Government’s approach to promoting its interests abroad. It comprises key players in Finland’s external economic relations, the internationalisation of Finnish enterprises, and investments in Finland and the country brand.

The general objectives of the network, set out in the Team Finland Strategy,\(^\text{325}\), are:

- Adapting to global value networks;
- Identifying and exploiting new opportunities; and
- How to use existing resources more productively and efficiently.

\(^\text{324}\) [http://www.sdi.co.uk/](http://www.sdi.co.uk/)

The Team Finland operating model brings together key players in these fields both at home and abroad who are then guided by shared goals approved by government. The aim is to create a clear, flexible and customer-oriented operating model where projects falling under the scope of Team Finland activities are carried out in cooperation between the public and private sectors.

At the heart of the Team Finland network are three Ministries – the Ministries of Employment and the Economy, Foreign Affairs and Education and Culture – together with publicly funded bodies and Finnish offices abroad (including diplomatic missions, the offices of Finpro and Tekes, and national culture and science institutes).

While publicly funded bodies make up the core of the network, cooperation with, for instance, enterprises, organisations and universities are also important.

More than 70 teams represent the Team Finland network overseas. Each local team gathers together the Finnish authorities, publicly funded organisations, and other key stakeholders representing Finland in a particular area in the world.

9.57 Moreover, the fact that Scotland could take a fresh look at overseas representation, through the prism of Scottish interests and values, provides an opportunity to be creative about bringing together diplomacy, trade and cultural promotion. This is something that the Scottish Government believes a number of countries of comparable size to Scotland notably Ireland, New Zealand and Norway, have done highly successfully.

9.58 Under independence future Scottish governments would also be able to complement the use of these “softer” powers by using the full range of economic levers to support and encourage international trade and investment. For example, by using taxation to support a stronger manufacturing sector – a sector that is characterised by its higher propensity to trade, global supply chain links and general business growth and development; responding to challenges regarding access to finance (which can often be faced by firms wishing to export); and through continuing to improve Scotland’s international connectivity.

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326 Finpro is the national trade, internationalisation and investment development organisation in Finland
327 Tekes is a publicly funded expert organisation financing research, development and innovation in Finland – Box 6.2.
International Connections

9.59 As highlighted above, connectivity – covering Scotland’s air, rail and sea, as well as digital connections – is an important contributor to the overall business environment. This is an area where Scotland needs to improve.

9.60 In the modern global economy, air connections are a key aspect of international connectivity.

9.61 Analysis conducted on behalf of the Scottish Government by aviasolutions, based on data available in Summer 2011, indicated that Scotland’s short haul network had almost reached the level of connectivity that would be expected when compared to peer regional networks.

9.62 However, Scotland’s long haul network performance is not as strong and there are clear areas for improvement in destinations such as the Asia Pacific region and North America.

9.63 Direct policy levers – for example, careful design of Air Passenger Duty – can be used to encourage the types of flights of benefit to Scotland to become established. Analysis suggests that the current APD regime negatively impacts on the Scottish economy, with APD in the UK now the highest tax of its type anywhere in the world.328

9.64 But such policy action could also be more creative.

9.65 As an independent nation, Scotland would be better placed to work with airport, airline, tourism and other partners to sustain network development activity in long haul markets – as part of a Team Scotland approach. The Irish Government has for example struck a deal with Customs Authorities in the US to allow passengers travelling through airports in Ireland to clear passport control before boarding the plane.330

330 http://www.taoiseach.gov.ie/eng/News/Archives/2010/Taoiseach's_Speeches_2010/Speech_by_the_Taoiseach_at_the_Opening_of_Terminal_2_T2_Dublin_Airport_on_19_November_2010.html
9.66 As with all policy choices such decisions – e.g. on APD – would have to be carefully managed, both financially and from an environmental perspective, but there is no reason why modest investments could not be made. In principle, if designed correctly they would have the potential to stimulate additional revenues for the Scottish Exchequer and reduce global emissions from aviation by cutting down the need to re-direct through London or other hub airports.

**Conclusion**

9.67 Independence would allow Scotland to take its place as an independent state on the international stage.

9.68 It would allow Scotland to build on the reputation which it has already established and to strengthen, and establish new, relationships with the international economic community.

9.69 A key part of Scotland’s international engagement will be its role as an active and constructive independent member state of the European Union.

9.70 With the additional powers provided through independence the Government of an independent Scotland would be able to:

- Boost Scotland’s presence on the international stage, providing greater brand recognition for Scotland’s economy and businesses;
- Better organise the structures that support trade in order to deliver a more efficient and joined up approach which made decision-making less bureaucratic, time-consuming and costly;
- Take the opportunity to use its additional powers, including “soft” powers, to develop Scotland’s national brand or reputation;
- Better represent Scotland’s interests as a full and equal partner in the EU system of governance to influence the development of the rules and regulations that support the effective operation of the single market;
• Build on the successful Team Scotland approach to optimise policy coherence across both public, private and third sector actors, and ensure that Scottish representation on the international stage supports Scottish industry; and,

• Work with airport, airline, tourism and other partners – as part of a Team Scotland approach - to sustain network development activity in both short and long haul markets.
Chapter 10: Conclusions

10.1 On 18 September 2014 the people of Scotland will face a crucial choice.

10.2 At the heart of the debate will be a decision on how, in an increasingly competitive global economy, long-term job security, sustainable growth, economic resilience and equality can best be secured for the future.

10.3 One option is to continue with the status-quo and to use devolved powers in an effort to be a successful economy within the UK. At the same time, Scotland could continue to hand the UK Government control over the key powers of Scotland’s economy including tax, welfare and regulation.

10.4 On the basis of the evidence in this report a decision to remain part of the status quo will see Scotland miss out on the increased levels of economic growth that can be achieved through targeted policy making. This would also see Scotland fail to make the vital connections between welfare, taxation, skills and employment that could dramatically reduce inequality or to receive the benefits that better designed public services – for example increased childcare – can deliver for the economy. It will almost certainly result in a relative reduction in Scottish public spending over the long-term.

10.5 It would also leave the people of Scotland exposed to the risks of an economic system that is likely to continue to be one of the most unequal in the OECD, is prone to instability, is increasingly unbalanced, is less resilient than competitors and has significant imbalances in regional prosperity. Scotland’s economy is likely to become increasingly tied to these UK wide trends. The Scottish Government has greater ambitions for Scotland.

10.6 The other option is independence. Under independence the Government of Scotland will secure the powers of a normal national economy. This will enable Scotland to take advantage of its vast resources and talent and to prioritise economic and social policies for Scotland’s needs and circumstances.

10.7 The Scottish Government believes that Scotland’s economic performance will always be constrained under the current framework, and that it is only through independence that Scotland can maximise its potential and deliver the type of economy and society that reflects the values of the people who live and work here.
10.8 Removing the weaknesses and constraints of the current economic framework will enable Scotland to implement policies that are developed around the dual purpose of ensuring short-run responsiveness and long-run competitiveness.

10.9 Boosting economic performance and tackling long-standing inequalities in society will take time. There are no overnight solutions. It will also imply careful decisions and choices over priorities. However, these would be taken by those with the greatest stake in the future success of the Scottish economy – the people of Scotland.

10.10 This report has not set out a prescriptive set of policies, but illustrates what ‘choice’ could look like under independence. The policy examples in this paper would allow future Scottish governments – whatever their political colour – to deliver transformational change at all levels of Scotland’s economy and society.

10.11 Greater autonomy will also bring increased responsibility. As highlighted in Chapter 2, the UK’s track record on economic management is poor. Future Scottish independent governments can ensure that in achieving greater levels of economic growth there is also a focus on securing long term economic stability.

10.12 As an independent nation Scotland will also have to respond to new challenges. This is not something that should be feared.

10.13 The evidence shows that countries of a similar size to Scotland with the full powers of independence have built stronger and more equitable economies, securing more of the benefits of their economy for the people of their country. On many measures of economic and social wellbeing comparable independent nations outperform Scotland. Smaller independent nations have also been shown to be more secure in their finances and long term future than Scotland can be as part of the UK.

10.14 With independence, it would be possible for future Scottish governments to –

- Set out a vision for the type of economy and society that captures the values of the people of Scotland and creating distinct economic, industrial and social policies which reflects these aims;

- Use welfare and employment policies to tackle long-standing inequalities – both social and regional – that have persisted for decades and re-invest the proceeds of success in creating a fairer and more inclusive society;
• Use tax powers, regulation and Scotland’s new global status to develop growth sectors and growth companies, widen the export base, attract investment, and support local firms to move into new and emerging markets;
• Develop an industrial strategy that promotes manufacturing and its links to the local supply chain;
• Use the full array of business policy – affecting large and small companies – alongside the resources of the public sector and Scotland’s universities and colleges to support innovation and expand the business base;
• Prioritise specific policy initiatives to areas that currently hold Scotland back - for example, aviation duty and its links to international connectivity;
• Build a more resilient and stable macroeconomic framework;
• Design a more efficient tax system;
• Implement an improved and streamlined consumer protection and regulatory regime which cut back on waste and duplication;
• Coordinate devolved powers with new tax and expenditure responsibilities - for example, in skills and employability, childcare, tax and welfare – to deliver more joined-up policy responses;
• Provides the infrastructure required for rural areas to fully participate in economic life through improved communications technology, community enterprises and a focus on innovation in traditional industries such as food and drink, agriculture and fishing;
• Use full responsibility for Scotland’s natural resources, such as control of the sea-bed, to maximise opportunities from the low carbon economy; and,
• Align education and skills policy with industrial and employment policies to facilitate more – high value – employment opportunities and the objective of full employment.

10.15 Scotland is a wealthy nation. In its people, natural resources, skills and innovative spirit the nation has the attributes of a successful and prosperous nation.

10.16 The Scottish Government believes that business as usual is no longer appropriate for Scotland. A vote for independence would provide tremendous economic opportunities. A vote for independence has the power to be transformational and to fundamentally re-balance Scotland’s economy, improving prospects for employment, job security and prosperity at every level of society.
10.17 A vote for independence can ensure all of Scotland benefits from the nation’s wealth now and in the long term – improving living standards, increasing employment and building a fairer society.