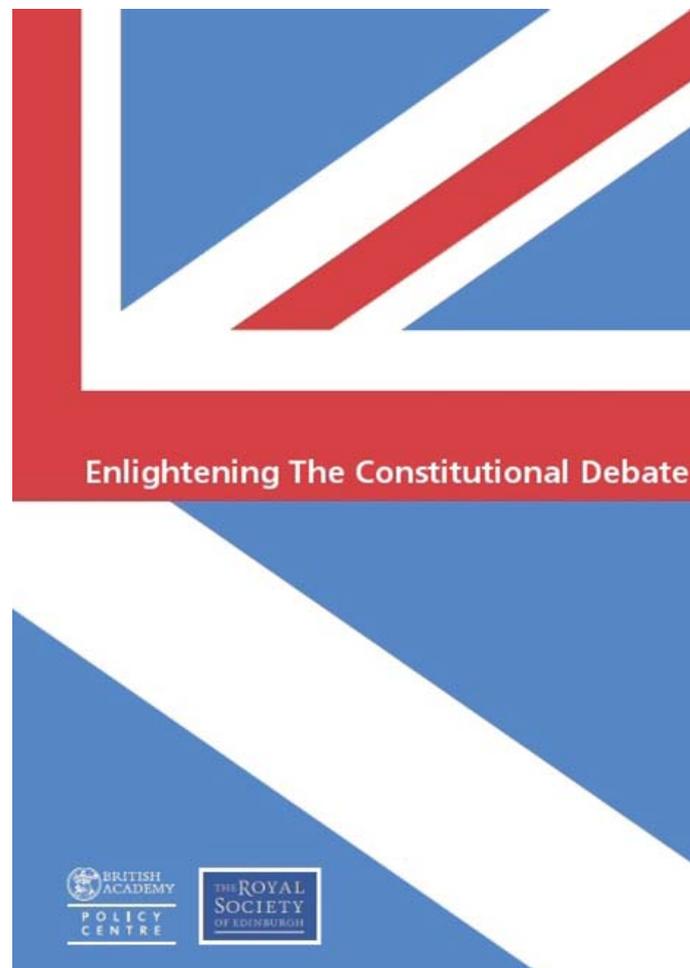


The second in a series of discussion events to enlighten the public debate on Scotland's constitutional future.

## Tax and Spending

17 April 2013

at the British Academy, Carlton House Terrace, London



This seminar consisted of presentations by three speakers followed by a round-table discussion forum.

The Chatham House rule applied.

## UK Government's Scotland Analysis Programme

A programme of work is currently being run by the UK Government with the aim of examining Scotland's place within the UK and how this might be affected by different constitutional options, including an independent Scotland. This programme will look at and analyse Scotland's existing arrangements as part of the UK, covering topics including the constitution; the economy; public finance; taxation; defence; energy; and welfare. Where possible and appropriate, the programme will also explore the potential implications of Scottish independence for each of these areas. It was observed that the UK Government has been keen to engage with and gather evidence from third parties including academics, think-tanks and other experts, especially those based in Scotland. Some of the key, cross-cutting themes that will be examined as part of this programme of work were identified as being:

- The opportunity for Scotland to pool risks with the rest of the UK, for example in relation to military or security threats, or economic challenges;
- The scale of the UK, particularly in relation to its ability to access a larger single, domestic market in which firms from key sectors conduct the majority of their trade;
- The potential influence of the UK on Scotland's behalf in international institutions;
- The levels of integration reached by Scotland and the rest of the UK, including institutions which are shared across the UK.

It was observed that uncertainty remained around how these functions would be replaced in an independent Scotland.

Debate to date has largely been based around Government revenue and expenditure statistics produced by the Scottish Government (Government Expenditure and Revenue Scotland – GERS). It was acknowledged that this is an important set of statistics for analysing fiscal issues in Scotland. However it was also pointed out that these statistics are viewed by the UK Government as a set of sub-national accounts, which is implicit in the fact that they break down UK level data into a Scottish component. The position of the UK Government is that there is difficulty around an assumption that these figures represent the likely fiscal position of a future, independent Scotland. This difficulty is exacerbated by the fact that the figures are backward looking, and cannot be reliably used to predict the fiscal situation for a future Scotland. It was suggested that there is a clear need for a reliable set of predictions on what this future fiscal situation might be. It was noted that GERS does provide useful evidence on the status of Scotland's public finances as part of the UK.

Referring to charts made available on the day, it was observed that at an aggregate level Scotland has enjoyed consistently high levels of public spending, around 10% higher than the rest of the UK, with relatively similar onshore tax revenues. This means that the gap between onshore tax and spend is bigger in Scotland than in the rest of the UK.

It was acknowledged that this analysis does not give the full picture however, since it does not take into account North Sea Oil revenues. North Sea Oil revenue offsets Scotland's higher public spending to some degree, and it was suggested that this fact demonstrates the importance of the North Sea Oil revenue to Scotland's fiscal situation and to the debate on Scotland's fiscal future. The volatility of North Sea Oil revenues was referred to, and it was suggested that while this volatility can be managed quite well at the UK level – where North Sea Oil receipts account for between 1% and 2% of overall receipts - at the Scottish level, where these receipts constitute around 10% to 20% of overall receipts, the impact of this volatility is likely to be much greater.

Having discussed Scotland's fiscal situation based on past data provided by GERS, attention was turned to current financial issues facing HM Treasury and the Scottish Government, with funding reform and accountability identified as key. It was observed that the Scotland Act (2012) represents the biggest transfer of fiscal powers in 300 years, giving the Scottish Government powers over income tax, stamp-duty-land tax, land-fill tax, along with borrowing powers which enable it to vary the levels of tax and spending in Scotland. It was also observed that the Scotland Act (2012) will increase the amount of self-financing in the Scottish budget, from around 15% as things stand at the moment to around one-third once the powers afforded by the Act are fully introduced, from 2016/2017. It was pointed out that enacting these new powers is merely the start, and that the process of fiscal devolution represents new and complex territory for both the Scottish and UK Governments.

With regard to Scotland's future, it was pointed out that a feature of almost all developed economies is that they will experience long-term fiscal pressures of one form or another. The most common of these are an ageing population and declining resources, both of which apply to the UK and Scotland. It was suggested that these pressures are likely to be felt more acutely in Scotland than by the UK as a whole. Two pressures particularly likely to impact upon Scotland in the future were identified: a decline in oil and gas revenues; and a high dependency ratio within the Scottish population. These two pressures were discussed in turn.

**1 Declining oil and gas revenues:** A chart produced by the Office for Budget Responsibility (OBR) was referred to, demonstrating a long-term decline in oil revenues for the UK as a whole. Referring to the earlier chart demonstrating Scotland's heavier reliance on oil revenues compared with the rest of the UK, it was pointed out that the impact of this on Scotland's public finances could be profound. The OBR forecast indicates that by 2016/17 oil receipts will reduce by half, compared with recent years. The question was raised as to how this gap in revenue would be funded going forward, particularly in an independent Scotland.

**2 Demographic pressures and the dependency ratio:** A chart showing the dependency ratio (which was described

by the speaker as being the ratio of persons aged 65 and over to persons aged 15 to 65) for the UK and Scotland was referred to. It was observed that Scotland and the UK are currently in a similar position, but that the forecast shows a divergence, with Scotland's dependency ratio increasing more significantly than that of the UK. The point was raised that this demographic trend, representing a decline in the working age population, is likely to impact upon Scotland's tax base, and also upon money available for public services.

Taking the identified fiscal pressures facing a future Scotland, and the GERS analysis discussed earlier, the question was posed: What does the future fiscal position of Scotland look like? It was observed that there are very few estimates of this available at the moment, and even fewer which extend beyond the medium and into the long term. A fiscal forecast produced by the Centre for Public Policy for Regions (CPPR)<sup>1</sup> at the University of Glasgow was referred to as providing the most up to date estimate currently available. This forecast uses the GERS and the OBR data, and predicts that while UK and Scottish fiscal situations are currently very similar there will be a divergence towards 2017/18, with the UK fiscal position improving more rapidly, but with both countries remaining in deficit. It was suggested that many more estimates like this one are needed to help inform the debate about Scotland's fiscal future.

### **Principles for Distributing a Block Grant around the UK**

The question of how the arrangement for a block grant might be reformed in the light of possible constitutional change in Scotland is an example of an issue pertinent to England, Northern Ireland and Wales, as well as to Scotland.

There are two main components of identifiable public spending, these being formula spend and entitlement spend. Entitlement spend refers to expenditure which is based purely on entitlement, for example welfare benefits, and which goes to those who are entitled to it, wherever they may be geographically. It was explained that the UK currently operates on a system of formula funding, according to which locally delivered services are funded on the basis of complex formulae which calculate the spending need of Local Authorities in different policy areas, on the basis of relevant characteristics of the local population. A formula based system also underlies the allocation of funding by HM Treasury to the four regions of the UK - England, Scotland, Wales and Northern Ireland – by means of the Barnett formula. This formula dates from the 1970s, and adjusts the amount of public expenditure allocated to the devolved regions of the UK in accordance with changes to public expenditure in England.

It was pointed out that the system employed by HM Treasury for the allocation of block grants to the four regions of the UK represents an expenditure based system, with expenditures in England on those policy areas devolved to the territories in question forming the basis for the block grant to each

territory. This expenditure based system also underlies the formulae applied by each region of the UK when allocating revenue support grants for Local Authorities. It was explained that these formulae are typically based upon an index of need for each Local Authority, which is driven by relevant demographic indicators such as morbidity and mortality for each area. It was pointed out that these formulae are slightly different, and take into account slightly different indicators, in each of the four regions of the UK.

The expenditure based model differs from a revenue based model, which would start by looking at the taxing capacity of each region or each Local Authority. It was suggested that although the tax-raising capacity of Local Authorities does enter into the formulae of the four regions of the UK, this in no way forms a central part of formula funding across the UK. The UK formula system cannot therefore be considered revenue based, except in the most trivial sense.

Scrutinising the current, expenditure based model, a piece of research undertaken by Stirling University, found that if the formulae used by England were to be applied to Scottish Local Authorities, and the formulae used by Scotland were to be applied to English Local Authorities, the results would be completely different. This was observed to raise some concern over the use of expenditure based systems. A report produced by the Independent Commission on Funding and Finance for Wales (ICFFW)<sup>2</sup> analysed how funding to Wales would look if Wales was treated as a region of England. Instead of directly re-running the English formulae, this piece of research looked at the results of the block grant allocations to each region of England and attempted to identify and explain what the main indicators determining allocations to each Local Authority in England are. The research showed that 95% of variations in funding can be attributed to four variable factors; poverty, cost (which is heavily affected by sparsity), dependency, and sickness. By applying the revealed preferences of the English formulae to Wales, it was revealed that Wales would get the same in block transfers as it does at present, as would Northern Ireland. Scotland, however, would get less. In terms of how we might proceed after the referendum, it was suggested that an expenditure based system applied across the rest of the UK is feasible, and could be an option if Scotland chooses independence. It is difficult to make this sort of system work if Scotland remains within the union however, and in that event the problem of how block grants should be allocated in the future remains to be solved.

The default position for Scotland in the event of a 'No' vote in the referendum is the full implementation of the Scotland Act (2012), which will entail a change in the way Scotland is currently financed. The default position in the event of a 'Yes' vote is Scottish independence, which does not remove the question of how a block grant for the rest of the UK should be distributed between Northern Ireland, Wales, and the regions of England.

<sup>1</sup><http://www.gla.ac.uk/schools/socialpolitical/cppr/currentpublications/>

<sup>2</sup><http://wales.gov.uk/funding/financereform/report/?lang=en>

## The potential fiscal situation in the event of Scottish independence

It is important when looking at Scottish independence to examine not only Scotland's potential fiscal position in comparison with the UK, but also to examine what the absolute fiscal positions of Scotland and the UK will be, both at the referendum and beyond. It was observed that the overall fiscal positions of both Scotland and the UK are unlikely to be 'happy'. The annual deficit in 2014 will still be very large, and will continue to be significant in 2016 and 2017 and the context of the short-term fiscal situation in the UK will be one of dramatic spending cuts. It was observed that the levels of outstanding national debt will continue to rise through 2014, 2015 and 2016. High levels of national debt will put the UK and Scotland in the top bracket of OECD countries on levels of debt, and will make Scotland in particular one of the only countries of its size and population to have such high debt.

It was suggested that the relative fiscal context of Scotland is, in the short-term, very straightforward, with Scottish income and tax per head being very similar to the rest of the UK and spending per head around 10% to 12% higher. Ignoring North Sea Oil revenues the Scottish deficit is higher than that of the UK, and taking account of Oil revenues it is roughly the same, although volatility is increased. Given the impact of North Sea Oil revenues, an important question going forward was highlighted as being *what will happen to oil revenues in the short and medium term?* If CPPR and OBR forecasts are correct, this will draw Scotland into a worse fiscal position than the rest of the UK over the next few years, although it was acknowledged that there is huge uncertainty around the future of oil revenues.

The question was posed as to what kind of fiscal architecture an independent Scotland might want to put in place; would Scotland, for example, want to put in place something like the OBR? A further question was posed around how an independent Scotland might account for volatile and diminishing oil revenues when thinking about what its fiscal rules ought to look like. It was suggested that cautious medium-term fiscal rules would remove oil revenues from the fiscal balance, so that over a protracted period a fiscal balance excluding oil revenues would be sought. It was

suggested that this approach is a possible equivalent to building up an 'oil fund'.

An independent Scotland would have many more tax choices. Scotland would be inheriting a tax system that is not optimal, and will have the opportunity to move towards a more rational and neutral tax system, should it so choose. It was suggested that there will be some questions in relation to the tax system which will be different for countries which are smaller and more open than the UK as a whole, for example:

- How to structure corporation tax – especially in a country which will remain very integrated with the rest of the UK;
- How to take account of cross border issues in indirect taxes; and
- How to think about whether there are differences in the responsiveness of labour supply and avoidance behaviour to rates of income tax and corporate tax.

The example of the taxation of alcohol was raised. It was observed that Scotland has introduced minimum pricing for alcohol rather than levying a higher tax on alcohol, and suggested that an independent Scotland would be able to tax alcohol as it chooses to, subject to EU rules.

It was further suggested that an independent Scotland would have many more choices available around spending; at present spending in Scotland is higher than the rest of the UK across every single devolved sector, not simply in relation to higher education, social welfare or health. Choices are available as to how Scotland manages its future spending.

Recognition was given to the earlier point that long-term fiscal issues in Scotland will probably look similar to those in the UK and other developed nations, for example regarding the ageing population and the associated pressure on health care plus increased fiscal challenges as a result of these factors. Initial analysis indicates the possibility of greater pressure as a result of these factors in Scotland however, due to a faster ageing population coupled with the structure of social care funding. Qualitatively the fiscal challenges facing Scotland will not be dissimilar to those facing the rest of the UK, but it was suggested that quantitatively Scotland's fiscal pressures may be more challenging than those faced by the rest of the UK.

## Questions & Answers

### *Division of National Debt*

A question was posed regarding the division of national debt should Scotland become independent. The Scottish Government was referenced as suggesting that Scotland takes a 'population share' of the national debt, and HM Treasury as also believing that a population share could be used to divide and allocate the national debt. The advantage of a population share is that it is easily understood and readily acceptable. It was pointed out, however, that there is a complication with this idea, which derives from the fact that the markets also have a say and an interest in the issue of the national debt. The primary concern of the market relates to ability to pay; if Scotland were to become independent, it would accrue around 10% of GDP and roughly the same proportion of tax raising power.

A population share of national debt would be based on Scotland's 8.4% of the UK population. It was suggested that an allocation of national debt based on Scotland's population share was likely to be rejected by the markets on the basis that it would place a greater burden of the national debt on the UK, and Scotland would be seen as getting off lightly. The market interest is predominantly in maintaining stability in the repayment of debt. It was pointed out that the UK Government has a commitment to not pre-negotiating the terms of independence, and that UK Government Ministers do not have a negotiating position to adopt on this issue as yet. It was observed that there are a number of methods for dividing the national debt, based for example on population share, or on GDP. All of these methods produce quite high numbers, but it is not yet possible to comment upon what the preferred method might be. The biggest challenge will be how to put any division of national debt into practice.

### *Social Welfare*

A point was raised about social welfare. It was observed that there will be a seminar on Welfare & Public Service as part of the Enlightening the Constitutional Debate series, and suggested that this is a key issue which takes us to the heart of the social union. A report produced by Sheffield Hallam University was referred to<sup>3</sup>, which examines the consequences for Scotland of the reform of welfare. It was suggested that if Scotland were to become independent it would be possible to devise a system of social welfare very different from the existing one. It was further suggested that the issue of social welfare is one which lies at the centre of the case for the social union. Closely related to this is the question around state and public sector pension provision, the regulation of pensions in an independent Scotland, and the transition of pensions between states, for example the possibility of accruing pension entitlements in state A and receiving payments in state B. It was suggested that these

issues are all central to the continuity of the social union.

It was suggested that with regard to the welfare debate, the issue for the UK Government is two-fold; there is one issue relating to affordability, which is about reducing the welfare bill, and a second issue around providing the right incentives to get people back into work. It was acknowledged that the pension questions are very tricky, particularly with regard to the transfer of entitlements across national boundaries and the continuation of entitlements already accrued in the event of independence. It was suggested that there is a large amount of uncertainty in this area.

### *Controls on Funding*

An observation was made about the controls that will be applied to funds allocated to Scotland from the UK budget. While much of the discussion so far has focussed upon the different approaches that might be applied to the allocation of funds, for example expenditure based or revenue based systems, it was suggested that a further consideration is around what sorts of controls will be applied to any money allocated to Scotland. The point was raised that when the 1998 Scotland Act was passed and the block grant was being discussed, the money allocated to Scotland came with very few strings. It was pointed out that gradually restrictions have been applied so that there are now rigid controls and far less flexibility. The point was made that when budgets are tight, there is a tendency to operate in the margins, so anything which affects these becomes very important. There is a lot of UK central control over policy decisions that can be made in Scotland.

Speakers recognised that there has been a tightening up of the regulations and restrictions applied to the funds allocated to Scotland, but suggested that these controls are put in place to ensure that the credibility HM Treasury has within global markets is maintained. It was suggested that the tightening of controls has been part of a move towards an overall strategy to reduce the deficit.

### *Revenue Data*

A question was raised about revenue, and it was suggested that there are certain revenue figures on which we don't currently have clarity, in particular corporation tax. It was pointed out that just two or three percentage points, when dealing with large fiscal deficits, can make a huge difference, and yet these figures are not fully understood. The question was posed as to whether there are any proposals for HM Revenue and Customs to try and deal with this issue.

Quite a lot of data on spending is geographic, but with some areas of taxation this is more difficult. With corporation tax,

<sup>3</sup>[http://www.scottish.parliament.uk/S4\\_Welfare\\_Reform\\_Committee/Reports/wrR-13-02w.pdf](http://www.scottish.parliament.uk/S4_Welfare_Reform_Committee/Reports/wrR-13-02w.pdf)

for example, a lot of data raised is based on where the company is headquartered and not where the tax itself is accrued. Getting a more detailed picture of these areas is therefore likely to be a challenge. It was suggested that it would be useful to examine the way tax receipts break down across the UK and that this is something the UK Government will want to look into.

### *Fiscal Rules*

A question was raised relating to fiscal rules, and what currency arrangements will be assumed when looking at these. It was pointed out that fiscal policy within a monetary union is wholly different to having a floating currency. A comment was also made on the position of non pre-negotiation on Scotland's constitutional future taken by UK Ministers. It was indicated that while pre-negotiation is not expected, it would be helpful to have a statement from the UK Government about principles that might be applied, for example in relation to the separation of the national debt. It was suggested that refusal to provide this is more of a political tactic than something which is assisting open and fair debate, and the refusal of the UK Government to pre-negotiate on Scotland's constitutional future was contrasted with the position taken by the UK Government on Europe and UK membership of the EU.

It was pointed out that if Scotland becomes part of the EU it will be bound by the fiscal rules set by the Eurozone, however if it was part of a sterling zone then consideration would need to be given to the fiscal rules that would be applied. It was observed that the implications of different currency arrangements will be very different and that UK fiscal rules are far less binding than EU fiscal rules would be.

### *Division of National Debt*

The earlier point regarding the division of the national debt was returned to. It was observed that in relation to the Quebec referendum, which was conducted in 1995 at a time when Canada was suffering a sovereign debt crisis, the lack of clarity around issues such as the division of this debt caused an enormous amount of uncertainty, which was reflected in the markets. It was further observed that when opinion polls began to demonstrate that there could be a 'Yes' vote in the referendum, there was a fall in the value

of the Canadian dollar and a spike in interest rates because of 'capital flight' – the flow of assets and money out of the country. It was suggested that the reluctance of the UK Government to open up pre-negotiation could raise the possibility of uncertainty and economic disruption across the whole of the UK.

A point was made regarding the GERS figures referred to in the speaker presentations. It was suggested that as members of the public we are asked to make choices effectively on this one source of data. The majority of tax data in GERS is extrapolated from UK figures, and no separate sampling or stress testing of GERS data is undertaken. The point was made that by using a different method for calculating corporation tax, different conclusions are reached, and that even if GERS is only 5% or 10% out, in real terms this amounts to around half a billion pounds. HMRC and the UK Government should acknowledge that GERS is not as robust as it has been thought to be.

### *Fiscal Autonomy*

A further point was made in relation to Scotland's fiscal autonomy. It was pointed out that the Scottish Parliament has always had the ability to raise additional levies, but politically it has never chosen to do so for a number of reasons.

In response to this point, it was suggested that the examples given of tax and spend decisions taken (or not taken) by the Scottish Government, illustrate the issues about having an expenditure based rather than a revenue based system. The Scottish Parliament has always had revenue options; from the Scotland Act (1998) until the full implementation of the Scotland Act (2012) it has had the power to vary income and property tax, and has shown no interest in doing anything with this power other than to freeze council tax. It was suggested that the consultation held by the current Scottish Government on stamp duty land tax perhaps demonstrates that the Scottish Government are beginning to think about what a rational tax package might look like, however it was observed that a more robust and responsive tax system is difficult to achieve within the current expenditure based system.

At this point the Q & A session was drawn to a close and more open discussion invited.

## Discussion

Opening the discussion, a point was made that in the current debate around currency and fiscal choices, we are frequently constrained by the fact that our analysis and tools are based on the world as it was pre 2007, when in fact the world has changed quite considerably since 2007. A further concern was expressed about the longevity of work being done at the moment. It was observed that new fiscal rules and policies may need to last up to 300 years, and will therefore need to be robust. It was also observed that issues of fiscal policy are wider than Scotland and the UK, and have relevance throughout Europe. It was therefore suggested that we need to think more broadly about how certain types of risk sharing can be done, and how fiscal unions across borders might work and what this means for nationalism in the broader sense.

The issue of risk sharing was discussed in further detail, and the question of which risks are shared at which level was identified as important. It was suggested that prominent risks to consider are those which we have traditionally sought to insure against with the welfare state, for example through old age pensions, unemployment insurance, and sickness benefits. It was observed that in the European context there is no automatic assumption that German tax-payers pay Greek pensions, for example, whereas there is an assumption within the UK that UK tax-payers will pool resources in order to pay UK pensions and social security benefits, even where this involves transfers across subnational boundaries. It was observed that there is a purely nationalist view identifiable in relation to discourse in Scotland, which argues that the sharing community for this purpose should be Scotland, and that Scotland and Scottish people would be better off under this arrangement because of North Sea Oil revenues. It was further observed that an 'undeveloped' argument in the opposite direction holds that once state boundaries have been set, that is the area within which you share. The unionist side of the Scottish debate has not successfully unpacked that argument yet. With regard to public expenditure distribution, discussion tends to focus on block grants, but the biggest element of public spending is social security. There was thought to be an interesting question around whether there is any possibility for a devolved Scottish-only solution to the distribution of public expenditure, as opposed to an independent Scottish-only solution, i.e. *is there a system under which we can decentralise social security?*

On the subject of welfare, it was suggested that it is possible to imagine a settlement whereby Scotland has control over the main elements of redistribution but agrees risk sharing with other jurisdictions. It was pointed out that this does happen in some federations; in the Canadian context for example there is a social union which does not depend upon the notion of a shared national identity. The notion of social risk is changing to take account of new social risks, many of which are being dealt with at the sub-state level because they involve linking social interventions with active labour

market and economic policy. It was suggested that this is the area of the welfare state where a lot of innovation is taking place. The observation was made that in the UK the focus is more on passive support than active support, and it was suggested that this needs to change. A change from passive to more active support will have implications for how services will be delivered, and undermines the idea that everything should be delivered at the level of the nation state. Looking at particular examples, like getting people into work, it was observed that passive support is delivered at the national level and that more active support is devolved to the local level, and that this does not provide good incentives for getting people back into work. Different philosophies for how people can be encouraged and supported into work do exist at the local level; Scotland for example is seen as having less sympathy for punitive measures designed to get people into work than England. It was suggested that there is a tendency to look at the welfare state of 10 years ago when discussing these issues, instead of the welfare state of the future. In thinking about the welfare state of the future it is important to consider policy issues first and taxation after. A final point was made about fiscal equalisation and sharing; there are no obvious examples of states that have succeeded in arriving at a permanent method for sharing resources. Instead, most European countries deal with the question sequentially, one problem / barrier at a time. This was referred to as 'fixing the squeaky wheel', and it was suggested that there is no solution to that because there is a 'messy' political reality which drives these things.

In response to this comment, it was suggested that Ireland was a 'squeaky wheel' for the British Government from the time formula funding started, and that funding for Northern Ireland and Scotland has also been problematic. Wales, however, has never been a squeaky wheel, and neither have most regions of England. It was observed that there has to be a more robust way of managing things than simply 'oiling squeaky wheels' or dealing with problems sequentially. It was suggested that the report referred to earlier, by the ICFW, provides a set of proposals which could be the basis for a coherent, UK wide expenditure based system. It was also pointed out that there are revenue based systems available too.

Bringing the discussion back round to the forthcoming referendum on Scottish independence, it was pointed out that, regardless of the outcome of the referendum, the status quo will not be an option in Scotland. There will be three political parties in Scotland offering three different ways of implementing the full scope of the Scotland Act, or another offering to implement full Scottish independence. The issue therefore is how sustainable what comes after the referendum will be, and how long-lasting. It was observed that people in Scotland equate having their own Parliament with creating their own laws, but they don't typically equate it with fiscal issues. There is no tangible link, because taxes are currently handed over to the UK Government. Knowledge

of the link between the Scottish Government and the management of fiscal issues is something that is missing in the lead up to the referendum. It was suggested that plans and proposals for fiscal devolution should be developed and communicated to the Scottish people now, ahead of the referendum, so that voters have a clear view of what is on offer. If this is left until after the referendum, the public will have less engagement with the process.

Echoing the point that there will be no status quo after the referendum, it was observed that whatever the outcome, the Scottish referendum will be 'transformatory'. The union sought by Scottish people, it was suggested, is very different from the union that exists at present, in that Scottish people appear to want extensive self-government. The first question, therefore, is whether the union can adapt to what Scottish voters appear to want. The second question is: What are the implications of this likely to be for those who live in the rest of the UK? It was argued that if the union is to survive it will have to remake itself, and will have to find a way of balancing all interests across the union. The union need not necessarily be the sort of union we have been used to, which provides for relatively homogenous living across the UK, instead there will be a need to reconcile unity with diversity.

Responding to this point, it was acknowledged that Scottish opinion appears to be focussed on wanting greater devolution; however it was also observed that when Scottish people have been asked service by service what they want, for the majority of reserved policy areas people want things to be the same in Scotland as they are across the rest of the UK. A majority of people in Scotland, therefore, appear to want things to remain the same as they are for the rest of the UK, but also to want greater devolution. This was referred to as the devolution paradox, and it was suggested that if further devolution takes place the likely outcome is that very similar outcomes will be achieved in each devolved area. People tend to have strong attachments to the idea of being able to make their own decisions about things, but also to have attachments to the same substantive outcomes.

The question of national identity was raised, and it was suggested that this would be central in the event of a 'No' vote in the referendum, and would guide the question: What is the nature of the union you want to have? It was observed that Scotland and the UK may want different types of union. Union has always, in the Scottish case, meant decentralised power. From 1707, Scotland's union with the UK has entailed Scottish exceptionalism; the Scottish church was something that really mattered in 1707, and this remained resolutely separate. The Scottish legal system was also fairly distinct from and alien to the English legal system. By the end of the 20th Century, Scotland's devolution had become based around a series of administrative departments, so that around 50% of public spending in Scotland was devolved. This incremental process was crystallised by the creation of the Scottish Parliament, but the big questions of representation and taxation were not addressed, and they

need to be addressed now. This will involve some mixture between a revenue based and an expenditure based system, and between now and 2014 there needs to be a cohesive and stable offering for Scotland which is also appropriate for the rest of the UK.

On the basis of the suggestion that the *status quo* will not survive the referendum, it was observed that there will need to be a new settlement of some kind, and that, if Scotland eschews independence, a whole new set of questions about the nature of the union will be raised. Two points were raised in line with this; firstly, it will be unsustainable in the long-term to have a UK state in which the parliament in Scotland exists on the sufferance of the rest of the UK. Secondly, if a new settlement gives powers to Scotland which are seen as contributing to the long-term prosperity of Scotland, parts of the UK (for example the North-East) are likely to become very ill at ease with this settlement.

It was suggested that there is clearly some kind of relationship between the political decision to be the source of revenue raising and how people understand their identity. The political culture in Scotland is towards greater fiscal autonomy, and the question was raised: in a culture where the trajectory is towards greater fiscal autonomy, does that not raise questions about the community of risk and who it includes? The question posed was: what kind of lessons can be learned from other types of fiscal federalism, and is there something distinctive and interesting in the Scottish situation and the move towards greater fiscal autonomy?

In response it was observed that an unusual feature of Scotland is that the Parliament spends nearly half of public expenditure in the country, but has virtually no tax-raising powers. It was further observed that there is nowhere in which a subnational unit raises all of its own taxes. The main reason for this is that without some degree of transfer and redistribution it is impossible to take account of need.

A further response was offered which observed that there are some states in which a homogenous approach to the welfare state is taken, and there is a strong expectation that the state will do the same thing for everyone, regardless of location. There are other states in which attitudes to risk and to public services are more nuanced according to where people live, and in which welfare regimes vary significantly from one locality to another.

On the subject of Scottish exceptionalism, it was observed that there is a view amongst some that this exceptionalism can only be expressed through Scottish independence. The suggestion was made that this view is not as broadly held across Scotland as the present Government tends to believe, but that this view is certainly framing the present debate and needs to be taken seriously. It was observed that nobody believes that the referendum can be followed by the status quo and that regardless of the outcome it will need to be followed by a period of negotiation. The position of the UK Government with regards to pre-negotiation was

criticised, on the basis that there needs to be a debate on what a new settlement between Scotland and the UK might look like in the event of a 'Yes' vote and in the event of a 'No' vote. It is very difficult to succeed in enlightening the constitutional debate without this information.

In response to this a suggestion was made that the position of the UK Government is likely to be very influenced by what the opinion polls are showing. As long as opinion polls continue to indicate that the outcome of the referendum will be the maintenance of the union, it is unlikely the UK Government will invest time and resource in planning for an alternative outcome. It was suggested that if opinion polls did begin to show a likely 'Yes' vote in the referendum then the UK Government would seek to offer guidance on those things likely to become a political reality.

The position of the English was raised, and it was suggested that this has been somewhat neglected in the debate so far. The sustainability and coherence of some of the existing systems and processes for calculating the distribution of money in England was questioned, and the suggestion made that the manipulation of these processes by Local Authorities has been manifest. There has been an apparent desire to maintain this current system, and the question was therefore raised as to what the unforeseen consequences of changes to this system might be. The implication of discussion so far has been that it will be Scotland that has to change and adapt, but there might be significant implications, which are not yet being addressed, in relation to how things would operate in an England that is by far the greatest part of a remainder of the UK.

On the question of what the constitutional agreement will ultimately be, the point was made that dealing with fiscal issues sequentially is a risky approach because any mistakes made on how the national debt is settled now could end up being very costly down the line. It was suggested that there is a need to think more broadly about how the questions around fiscal issues fit in with the rest of the debate.

Revisiting the question of pre-negotiation, it was suggested that a helpful approach might be to distinguish between different issues. There might be areas of the debate where we can expect a degree of candour, but this does not apply to all questions relating to Scotland's future. There are questions about things that are beyond the negotiating power of either side of the constitutional debate, for example the question of an independent Scotland's relationship with the EU. While this can be influenced to some extent by the two sides of the debate, the question of whether the Scottish and UK Governments should try to find a joint position on this sort of issue is different from the question of whether they should seek a joint position on issues where they have different interests and negotiating stances to begin with. Understanding this distinction could help to interpret the levels of candour or pre-negotiation that might be encountered. In addition, there will also be

questions about what an independence scenario will look like, for example how the national debt will be shared, and about what the unionist alternatives might be. The point was made that unionist parties may not have a consensus on what the union looks like. It is important for the debate to separate these different questions and issues out.

The point was raised that there is a qualitative difference between the UK Government not pre-negotiating the possible terms of independence and the issue of whether there is clarity or consensus on what the available alternatives are in the event of a No vote. A question was raised about who should be involved in developing proposals for such alternatives in the event of a 'No' vote. For example, if the three unionist parties in Scotland are negotiating consensus, will the SNP have a seat at that negotiating table?

In response to this question the suggestion was made that this will probably depend on timing, and in particular on whether the discussion takes place before or after the referendum. It was observed that the key time for these discussions is not 2014 but 2015, because the principal source for a mandate is likely to be the pre-election manifestos for the UK general election in 2015. If there is a settlement that affects the whole of the UK it can be considered by voters then.

The point was made that the Scottish question should not be dealt with in isolation, but that there is a need for UK wide involvement. In the event of a 'No' vote in the referendum it was suggested that there should be recognition by UK political parties that the union as it is has not been working and that a UK convention should be developed for how the union will work on a UK wide basis, i.e. not just focussing on one specific region.

Speaking of the SNP, a suggestion was made that if there is to be a post-referendum scenario that is not Scottish independence, as the largest party in Scotland the SNP and their supporters will have to be part of this process. It was observed that the devolved Scottish Parliament is not functioning at its optimal level at the moment, in that it is not being held fully to account for policy outcomes. There will need to be a mechanism for measuring whether the Scottish Parliament is delivering positive policy outcomes.

Revisiting the earlier point on the need for a UK wide convention on the future of the UK post-referendum, it was suggested that part of the success of the UK to date is that it has never tried to 'essentialise' the union, instead the union has meant something different in each region of the UK. Constitutionalism in the UK is about dealing with diversity in considering the ultimate purpose of the union. The UK should be following a model of compromise, not trying to define the sovereignty or ultimate purpose of the UK. Referring to the devolution paradox discussed earlier it was observed that policy making is not about asking what people want service by service, it is about finding out what people want from a compromise. This enables recognition of the deep diversity of the UK.

A question was raised as to whether the topic of tax and spend is likely to be one of the defining battlegrounds of the referendum, or whether it is likely to be a peripheral issue. It was suggested that the complexity of the issues relating to tax and spending is quite high, and the UK and Scottish Governments have a tendency to produce complicated looking graphs which support the political view they hold. The point was made that this is an area in which people are struggling to feel that there is an authoritative, independent view of the situation. Is this issue simply going to be too complex for the public to engage with, or is it seen as a defining battle ground? If the latter, what happens next?

It was suggested that in the event of a 'No' vote in the referendum, the focus will be on fiscal devolution, and that the next logical step is to develop a convention on how fiscal devolution can be taken forward. A central question is likely to be: What happens to England? It was observed that debate will centre on the need for a genuinely needs-based formula to replace or modify the Barnett Formula. Another big question is likely to be the West Lothian question. It was reiterated that the status quo will not be the way forward.

At the end of the discussion, the Australian fiscal model was referred to. This is essentially an expenditure based system, but one which does not dis-incentivise sub-national parliaments from thinking seriously about the tax structure.

The point was made that the Scottish Parliament has never had to think about taxation, and therefore, never has. The Australian system is incentive compatible, but does not rely on redistribution mechanisms to take the strain. The Canadian model, it was observed, is a much more revenue based system, a requirement for this being that there is a lower expectation of national conformity than there is in the UK.

It was suggested that the Rate Support Grant system is broken in that it is over-complicated and subject to 'gaming'. A re-thinking of formula funding for local government services and health is needed.

Regarding the constitutional convention it was observed that this was felt to be a good idea in theory, but one which may be difficult in practice. It was suggested that were a political party to go into the next election promising a constitutional convention, this would give it a momentum that a Select Committee on its own cannot produce.

Referring to the deep diversity of the UK, it was observed that Scottish and English attitudes and approaches to 'big ticket' expenditure items are, and have been, quite similar. It was suggested that where there is deep diversity in the UK, it is in those historic areas referred to in earlier discussion, for example church and religion.

On this point, the seminar was drawn to its conclusion.



