David Eiser, Stuart McIntyre & Graeme Roy
Fraser of Allander Institute, Department of Economics, University of Strathclyde

Today's release of Government Expenditure and Revenue Statistics (GERS) is likely to re-ignite the constitutional debate in Scotland; sadly, not in the healthiest or most informed way.

Aside from the usual debate, today's statistics contain some interesting facts about the upcoming devolution of tax powers to the Scottish Parliament.

Usually this constitutional war of words takes place only once a year, but this year, the GERS figures for 2015-16 have been brought forward from their planned publication in March 2017 to today.

The first thing to emphasise is that claiming that the release of these data have been brought forward as a deliberate ploy to bury bad news is wide of the mark – and unfair on the independent civil servants who compile the statistics. As set out here, government statisticians have been in a process of public consultation to determine the optimal time for publication and exploring the possibility of using new methods to significantly accelerate publication. Statisticians are usually criticised for the delay in publications so this initiative – rather than being subject to criticism – should be welcomed. It also signals a new annual publication date for GERS .

Some background

GERS estimates the contribution of public sector revenue raised in Scotland toward the public sector goods and services provided for the benefit of Scotland. The estimates typically cause significant controversy, although statisticians in the Scottish Government have worked exceptionally hard in recent years to use new methods and data to improve the quality of the estimates.

Disputes over GERS now tends to focus on the principles in the methodology adopted rather than statistical accuracy – e.g. is it appropriate to allocate Scotland a per capita share of defence expenditure if the UK's defence footprint is slightly lower in Scotland than in the rest of the UK, or is it appropriate to allocate Scotland a per capita share of UK debt interest repayments if Scottish public spending has been higher than the rest of the UK in recent decades?

These arguments are not going to go away, and 'fairness' is something we each may have an opinion on, but the GERS figures present the most reasonable approximation to help us understand the nature and extent of public spending and revenue in Scotland.

The headline deficit

We'll leave it to others to pour over the political and constitutional implications of today's deficit figure.

Many will argue that it shows the benefit of the Union – the 'union dividend'. Others will argue that the figures demonstrate the weakness of the current economic model and the need for reform.

	£ million				
	2011-12	2012-13	2013-14	2014-15	2015-16
Scotland – Including North Sea revenue (geographical share)	-8,797	-13,997	-12,982	-14,311	-14,833
UK	-115,546	-123,216	-103,933	-91,668	-75,320
	As % of GDP				
Scotland – Including North Sea revenue (geographical share)	-5.7%	-9.2%	-8.2%	-9.1%	-9.5%
UK	-7.1%	-7.3%	-5.9%	-5.0%	-4.0%

For the financial year just passed, Scotland's deficit rose by £500m to £14.8bn. In contrast, the UK deficit fell by just over £16bn. As a share of GDP, Scotland's deficit is 9.5% of GDP compared to 4.0% for the UK.

Scotland's deficit this year is almost as large as its deficit at the height of the financial crisis in 2009-10 and back at levels last seen in the early 1990s.

A key reason for the weakening of Scotland's public finances has been the collapse in North Sea Revenues. Scottish oil and gas revenues were estimated at just £60m in 2015-16 – down from the near £10bn just four years ago.

It is highly unlikely that North Sea revenues will ever return to such levels in the future, even if the oil price recovers to $100 per barrel, given that the basin is entering its mature stage. The OBR predict that North Sea revenues will remain low for the foreseeable future – and will actually turn negative once various tax credits and decommissioning factors are included.

So what do today's figures tell us about independence?

On the one hand, not that much. The Scottish Government is right to say that GERS estimates Scotland's public sector finances as a mini-UK, and this comes with constraints and protections. A large part of the GERS expenditure and revenue figures are choices made by the UK Government rather than the Scottish Government (e.g. defence spending). And if the very point of independence is to take a different path over policy compared to the rest of the UK then it follows that Scotland's fiscal numbers would look quite different. We also know that the macroeconomic context would be quite different were Scotland to be independent, the extent of the change depending upon the arrangements adopted.

However, there is absolutely no escaping the fact that these numbers paint a very difficult picture of how Scotland would start out or transition to becoming an independent country. It is simply not possible to operate under independence with a deficit at this scale on a consistent basis – full stop. This means that in pursuing the case for Scottish Independence, the Scottish Government need to set out the tough choices that it would make alongside a detailed and comprehensive plan for how it would manage the public finances under independence. This won't be easy but is essential.

Some questions which might arise as a result of these numbers:

Would changing the methodology used in GERS change Scotland's deficit vis-à-vis the UK? Frankly, only really at the margin. Even very substantial (and unrealistic) changes in the calculation still leave Scotland with a significant net fiscal deficit. Take two examples, defence and debt interest repayments. Even if Scotland was to be allocated no such spending, the deficit would still stand at -6.2% of GDP (exc. North Sea revenue) and -5.7% of GDP (inc. a geographic share of North Sea revenue).

What about the outlook for the future, won't Scotland's deficit naturally fall with faster economic growth? To an extent. But the rate of economic growth required to eliminate the deficit – or even substantially reduce it – would exceed current forecasts and indeed the rates of growth seen in current lifetimes. Moreover, the outlook has been turned on its head by the EU referendum outcome and – if anything – progress on reducing the fiscal deficit is now likely to slow in the years ahead.

What about the analysis published yesterday which showed Brexit weakening Scottish public finances by £3.7bn? This matters very little for the fiscal position of Scotland relative to the UK. This hit to the Scottish public finances from Brexit is a common shock across the UK – indeed the £3.7bn figure is simply a Scottish share of the forecast shock at the UK level. So, the analysis yesterday says very little about Scotland's position relative to the UK.

Other interesting aspects of GERS

A number of tax powers are being devolved to the Scottish Parliament, following the recommendations of the Smith Commission. A new feature of GERS this year is that it reports the performance of these devolved taxes in Scotland relative to the UK as a whole over the period since 2011/12.

Under the arrangements set out in Scotland's Fiscal Framework, the Scottish Government's budget in coming years depends critically on the growth in revenues per capita from these devolved revenues in Scotland, relative to the growth in the equivalent revenues in the rest of the UK. If revenues per capita grow more quickly in Scotland, the Scottish budget will be better off than it would have been without tax devolution, and vice versa.

The data in GERS shows that tax revenues from Non-Savings Non-Dividend (NSND) income tax (which will be devolved to Scotland from April 2017) have grown at the same rate in Scotland as the UK as a whole since 2011/12. This means that if NSND income tax had been devolved in 2011/12, the Scottish budget wouldn't be much different compared to if it had not.

Will Scottish revenue growth from income tax match UK revenue growth in future? Nobody knows for sure. But with a weakening offshore sector (which pays higher wages than average) combined with a relatively more quickly ageing population, Scotland may find it harder to maintain per capita rates of tax revenue growth relative to the UK in forthcoming years.

There is a mixed picture from other devolved taxes. Scottish per capita revenues from LBTT have grown relatively more slowly than the UK equivalent Stamp Duty; but Scottish VAT revenues have grown more quickly.

We will consider the outlook for the devolved Scottish Budget – taking into account the likely future performance of devolved Scottish revenues and spending pressures facing the Scottish Government – in a report to be launched on 13th September.

Summary

In summary, today's GERS figures show that an independent Scotland would face a substantially higher deficit than the UK as a whole – if it became independent today and implemented today's tax and spending policies.

Beyond this headline finding – which will as usual trigger heated political debate about the implications and likelihood of independence – there are some other less appreciated points.

Both the UK as a whole and Scotland as an independent nation would find themselves in a position where some of the key taxes on which they have traditionally relied are under long-term decline. This is the case not only for offshore revenues but also revenues from onshore corporation tax, and revenues from fuel and tobacco duties.

With long-term spending pressures on the rise, there is an urgent need for governments to consider how these lost revenues might be replaced, if public finances are on a sustainable footing in future.