All-Party Parliamentary Taxation Group

Achieving Autonomy

What the independence referendum means for Scotland's fiscal future

'Scotland's Fiscal Future' series: First Report

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Foreword by Ian Liddell-Grainger MP

Dear Colleagues and Friends,

The independence referendum due to be held in Scotland in September 2014 has the potential to produce a major shift in the constitutional and fiscal relationship between the constituent parts of the UK. The All-Party Parliamentary Taxation Group (APPTG) welcomes the emergence of a serious and detailed discussion about the advantages and disadvantages for Scotland—and the UK as a whole—of both independence and continued membership of the Union.

The Scottish public deserve the best information available about the ramifications of either outcome, in order for them to come to the best decision in the referendum. Moreover, the wider British public—individuals, communities, and businesses—likewise ought to be kept abreast of developments in the autonomy debate, so that they are best prepared to respond to the financial or procedural impacts which the referendum could have for them. We are therefore pleased that the contrasting visions for Scotland proposed by the 'Yes Scotland' and 'Better Together' campaigns are starting to take shape, and we encourage campaigners on both sides to engage meaningfully with public opinion between now and the referendum.

This report provides a framework to analyse in detail the significance of the referendum outcome for future transfers of fiscal responsibility from Westminster to Holyrood. It puts the Scottish debate in the context of decentralising trends across Europe, and current and historical discussions of devolution and localism within the UK. The aim is to inform policymakers, researchers, and campaigners on the most prominent aspects of taxation policy in Scotland and the UK in general, and guide them in their formulation of clear, empirically sound proposals for Scotland's future before and after the referendum.

The APPTG's role in all of this is to contribute to the discussion and facilitate debate in Scotland and across the UK. We are objective, serve no partisan agenda, and believe that finding the best fiscal solution for Scotland is a cross-party issue. Over the coming year we intend to produce further research on taxation policy in Scotland, making our latest report 'Achieving Autonomy' the first in a series. 'Achieving Autonomy' is the result of a year of research, performed by our independent researcher—Marius Ostrowski. I would like to thank Marius, along with all the organisations and individuals who contributed to the research.

Kind Regards,

Ian Liddell-Grainger MP

Chairman

All-Party Parliamentary Taxation Group

About the All-Party Parliamentary Taxation Group

Ian Liddell-Grainger MP founded the APPTG in 2006 and continues to serve as its Chairman. It is made up of 20 parliamentarians with the purpose of looking at and understanding tax policy at all levels, and particularly tax administration. The APPTG has produced a series of papers and reports on tax administration and hosted a number of private and public events on a wide range of taxation issues. It has strong links with a broad spectrum of organisations and individuals across the tax space in the UK and internationally. The Chartered Institute of Taxation (CIOT) acts as the APPTG's Secretariat.

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About Marius Ostrowski — Author of 'Scotland's Choice'

Marius Ostrowski leads the APPTG's research project on Scotland's fiscal future, culminating in 'Scotland's Choice', the first in a series of reports for the APPTG. He is a Lecturer in Politics at Magdalen College, University of Oxford, and a doctoral student, researching federalism, civil society, and community identification. He holds First-Class BA Honours in Philosophy, Politics, and Economics (2007-10), and an MPhil in Political Theory (2010-12), both from the University of Oxford. He has worked with several think-tanks, including Demos, Reform, and the Institute of Economic Affairs, on a broad range of public policy initiatives, and has blogged and written regularly on localism and devolution in the United Kingdom and abroad.

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Executive Summary

0.i. The 2014 Scottish independence referendum is taking place against a background of growing calls for regional autonomy in a number of states throughout Europe. It marks a significant milestone within the UK's recent experience of decentralised power and responsibility since the passing of devolution legislation in 1998. A 'Yes' vote would trigger one of the most radical transformations in UK politics and society since Irish independence in 1922, and would have major implications for the trajectory of devolution in Wales, Northern Ireland, and other parts of the UK.

0.ii. 'Achieving Autonomy' is the first report in a series by the APPTG on Scotland's fiscal future within, or outside, the United Kingdom. It is the result of months of stakeholder research across government, policy advocacy, academia, business, and professional bodies. Our objective in this report is as follows:

- → Highlight the need for more research on the choice Scotland faces in the referendum;
- → Put forward a framework to assess the effects of this choice on Scotland's future fiscal autonomy;
- → Project a series of scenarios for Scotland's fiscal empowerment in possible referendum outcomes;
- → Evaluate the fiscal impact of the independence vote;
- → Provide recommendations for future research and government policy in this area.

0.iii. The APPTG believes that the debate over Scotland's future has been incompletely theorised, especially regarding fiscal policy. The APPTG notes a particular lack of public research in the following areas:

- → Engagement with what 'independence', and a vote for or against it, means from a fiscal perspective, and with the available alternatives;
- → Analysis of why Scotland is considering independence, tied to a deeper understanding of the macro political and economic constraints on its future fiscal autonomy;
- → Assessments of, and preparation for, the transition to any new arrangement, especially the timeframe and order in which further fiscal powers are transferred to Scottish control;
- → A vision for Scotland's fiscal trajectory after its new constitutional identity is finalised, including the internal restructuring of governance and policy innovation.

0.iv. This lack of research is primarily due to the absence of detailed engagement between HM Government and the Scottish Government. The result is chronic uncertainty for individuals, businesses, and communities in Scotland and the residual UK (RUK), as they are not receiving the guidance they need to adequately prepare for the effects of greater autonomy for Scotland. The risk is that under-information will needlessly inflate the organisational failures, delays, and administrative waste that would accompany any constitutional change, as well as fuelling doubt and scepticism among voters.

0.v. The purpose of this report is to provide analysis that starts to remedy these deficits. The APPTG's approach is rigorously cross-partisan, calling on a wide range of sources and stakeholders, with no preference for 'nationalist' or 'Unionist' sides, and no *ex ante* view on particular constitutional settlements for the UK. Its treatment of Scottish autonomy and independence is expressly analytic, empirical, and interpretative, and explicitly not judgmental, normative, or prescriptive. The question it addresses is not '*should Scotland become independent?*', nor '*could Scotland be independent?*', but '*what happens if Scotland chooses to, or not to, become independent?*'.

0.vi. This report clarifies the likely effects on Scottish fiscal policy of four types of outcome in the 2014 referendum, defined in terms of the vote share attained by either option: *outright* 'No' (<40% 'Yes'), *narrow* 'No' (40-50% 'Yes'), *narrow* 'Yes' (50-60% 'Yes'), and *outright* 'Yes' (>60% 'Yes'). For each outcome scenario, the report examines the effects on the major sources of government revenue (corporation tax, income tax, National Insurance Contributions, VAT, North Sea oil revenue, excise duties, and borrowing capacity), and its constitutional implications for the UK as a whole. In the two independence scenarios, it also examines the fiscal impact of the currency Scotland chooses, and its retention (or otherwise) of EU membership.

0.vii. Under outright 'No', termed *concessive devolution* (<40% 'Yes', >60% 'No'):

→ Further fiscal devolution only to the extent recommended by the Calman Commission;

→ Any further devolution only as a result of a 'National Conversation' about devolution, or through direct empowerment of local government;

→ Replacement of the Barnett Formula by a needs-based resource allocation mechanism;

→ Possible use of tax revenue assignment as a compromise between centralism and devolution.

0.viii. Under narrow 'No', termed *aspirational devolution* (40-50% 'Yes', 50-60% 'No'):

→ Extensive devolution of revenue sources not legally or pragmatically restricted to the central tier;

→ Employees' NICs reserved to preserve the core of the 'social Union';

→ VAT at most assigned under EU rules, using the formula $VAT_{Scot}(\%) = VAT_{UK}(\%) - h_{EU} - r_{UK}$;

→ Fuel and betting duties either pragmatically reserved or assigned by an *ad hoc* calculation;

→ Alcohol and tobacco duties either assigned or devolved;

→ North Sea oil revenue either reserved or geographically allocated;

→ Corporation tax either assigned or devolved;

→ Either/or decisions dependent on UK and Scottish Governments' aversion to revenue volatility;

→ All other taxes devolved, financing shortfall made up by borrowing and fiscal transfer mechanism.

0.ix. Under narrow 'Yes', termed *concessive independence* (50-60% 'Yes', 40-50% 'No'):

→ All taxes eventually devolved, and the block grant discontinued;

→ Retaining UK£ and EU membership would impose requirements for fiscal restraint and tax harmonisation on Scottish Government;

→ Income tax, corporation tax, NICs, VAT only able to deviate from extant UK rates by 1-2 'points', likely maximum deviation of 5 'points'.

0.x. Under outright 'Yes', termed *aspirational independence* (>60% 'Yes', <40% 'No'):

→ Scotland could consider moving to a separate Scot£ (transitionally pegged to UK£), making fiscal restraint requirements under currency union temporary;

→ It could also eschew EU membership in favour of 'weaker' attachment to Europe through EEA membership, weakening the pull towards harmonisation;

→ However, need for fiscal sustainability and market credibility would only add extra 1-2 'points' onto Scotland's maximum capacity for deviating from current UK rates.

0.xi. The APPTG notes that the degree of autonomy which Scotland ultimately attains depends on three factors:

→ A social or rivalrous vision of the relationship between the regions of the British Isles (subjective);

→ Confidence in the Scottish Government's economic management, and concern about market speculation (subjective);

→ Whether or not Scotland stays in a currency union with the UK (contingent).

0.xii. The APPTG suggests that the diverse options for increased Scottish fiscal (and constitutional) autonomy lie along a *continuum* of empowerment between the Scotland Act 2012 and full independence, according to the extent of control Scotland exercises over each tax area. It is clear from public opinion that the only acceptable change, if any, is a gradual progression along this continuum.

0.xiii. Further, the APPTG argues that, due to practical constraints, the long-run trend under devolution exhibits strong *convergence* with what is realistically possible under independence. A fully independent Scotland would be restricted to limited variation from the *status quo* of taxation policy, despite exercising technical decisive control. Likewise, the long-term trend under devolution would be for the Scottish Government to push for the maximum level of empowerment stably, or technically, compatible with maintaining the 'social Union'.

Table 0.1: Summary of the expected effects of the 2014 referendum

Outcome	No	Yes
Institutional model	Federalism	Confederalism
Supranational body membership	UK (EU?)	EEA / EU
Currency	UK£	UK£ / Scot£ (pegged)
Income tax	9-11% SRIT operating range	±1% at each income tax rate level
NIC	Fixed at UK rates	1-3% below UK rates
Corporation tax	12.5-17% operating range	12.5-17% operating range
North Sea oil revenue	Earmarked for eventual devolution	Full geographical allocation to Scotland
VAT	20% (UK rate)	15-25% operating range
Excise duties	Part-devolved, part-assigned/reserved	Scottish authority but EU harmonisation
Other taxes (local, land, APD, aggregates levy)	Fully under Scottish authority	Fully under Scottish authority
Public expenditure funding model	75-85% self-responsible 15-25% block grant	100% self-responsible

0.xiv. The APPTG also makes a series of recommendations for researchers and policymakers, including:

→ Both 'Yes Scotland' and 'Better Together' must offer views of what kind of society Scotland ought to become, in the context of both a 'Yes' and a 'No' vote;

→ Both the Scottish and UK Governments must acknowledge their duty of guidance towards individuals, businesses, and communities in Scotland and the RUK;

→ Researchers and policy-makers must provide exploratory analysis that takes the possibility of independence seriously, at least until September 2014;

→ The UK Government should formally commit to holding a 'National Conversation' about regional and local devolution immediately after the referendum, regardless of the outcome;

→ The Barnett Formula must be recalculated with the involvement of not just the Celtic regions, but also London and other English regions, to avoid persistent relative imbalances in public spending;

→ Given their greater contribution than corporation tax to total Scottish tax revenue, income tax, VAT, NICs, and excise duties should be prioritised in discussions about fiscal empowerment;

→ In the case of a 'Yes' vote, the Scottish and UK Governments must work together to address the fiscal implications for Scotland and the RUK of Scotland's continued use of UK£;

→ Given the effect of Scottish fiscal autonomy on taxpayers with over-the-border activity, the Scottish and UK Governments cannot delay negotiations until after the referendum;

→ The Scottish Government must establish a credible compatibility between endorsing progressive taxation and practising fiscal responsibility.

0.xv. The APPTG hopes that this report can help contribute both structure and substance to the debate about Scottish independence. We believe that the results it offers, and the arguments it explores, have the potential to resonate with current and future devolution questions across the UK, and further afield in Europe as well.

Introduction

0.1. On 15 October 2012, HM Government and the Scottish Government signed the Edinburgh Agreement, which set in motion the legal procedures for a referendum to be held on independence for Scotland.[1] With this agreement, some of the main questions about an independence referendum—its legality, its format, and the date on which it would be held—have now been settled: the Scottish Government will be granted the legal power by a Section 30 order to hold a single-question Yes/No referendum before the end of 2014.[2] This has now opened up the possibility for detailed, substantive engagement with the implications of Scottish independence for Scotland and the residual UK (RUK) to start taking place.

0.2. The presence of a (largely) fixed deadline for principled assessments of Scottish independence has added a definite degree of urgency to what was, up to now, a slow-moving, largely theoretical discussion. The key questions before the Edinburgh Agreement mostly concerned: (1) the legality and timing of the referendum; (2) the inclusion or otherwise of a 'third option' of (broadly speaking) greater devolution in the referendum question; and (3) the future ownership rights over North Sea oil reserves.

0.3. With the Edinburgh Agreement, the first key question has now largely been answered, with the exact date subsequently finalised as 18 September 2014. However, the decision to hold a single-question Yes/No referendum—i.e., to exclude a third 'devo' option from the offer to Scottish voters—has not fully ended debate on the practical implications of the precise phrasing of the referendum question as "Should Scotland be an independent country? Yes/No".[3] Specifically, it has not ruled out the possibility that some form of extended devolution may be implemented in Scotland in future, should the Scots choose to remain within the Union in September 2014.

0.4. While the division of North Sea oil between Scotland and RUK remains a contentious and unresolved issue, it threatens to crowd out more nuanced, yet nonetheless deeply necessary, discussion of other aspects of fiscal policy. The financial viability of a more autonomous Scotland does not only rest on its capacity to use oil revenue to balance its books, but also on the precise combination of economic levers the Scottish Government has at its disposal. Thus, any assessments of future Scottish financial well-being must consider the balance of spending and tax-raising powers devolved from Westminster to Holyrood that best allows Scotland to safeguard its long-run economic stability.

0.5. Also, while several assessments have been published that consider the economic viability of a sovereign Scottish state, less attention has been paid to the actual transition from the *status quo* to a new constitutional arrangement. The typical approach of assessments so far has been to examine the macroeconomic viability of a hypothetical free-standing future Scottish state, after the process of separation has been completed. There has been limited discussion of the way in which the fiscal powers retained by Westminster after the implementation of the Scotland Act 2012 would be transferred, in terms of the precise timeframe over which, and the order in which, this would take place.[4]

0.6. HM Government's stated position is that it "is not making plans for independence as [it is] confident that people in Scotland will continue to support Scotland remaining within the UK in any referendum."[5] The (now former) Secretary of State for Scotland, Michael Moore MP, has explicitly ruled out any further negotiations between the Scottish and UK governments beyond the level of "technical discussions" before

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[1] 'Scottish independence: Cameron and Salmond strike referendum deal', *BBC News*, 15 October 2012.

[2] HM Government and The Scottish Government, 'Agreement between the United Kingdom Government and the Scottish Government on a referendum on independence for Scotland' (2012).

[3] Electoral Commission, *Referendum on independence for Scotland: Advice of the Electoral Commission on the proposed referendum question* (2013), p.33. The question on which consultation was taken, and which this phrasing superseded, was "Do you agree that Scotland should be an independent country?". For more background, see 'Scottish independence: SNP confirms referendum question', *BBC News*, 9 November 2012; 'Scottish independence: MPs grill campaign bosses Jenkins and McDougall', *BBC News*, 20 November 2012.

[4] David Gauke MP (Exchequer Secretary to the Treasury), *Interview*, 18 December 2012; Scottish Government, *Scotland's Future: from the Referendum to Independence and a Written Constitution* (2013), pp.13-14.

[5] Philip Hammond MP (Secretary of State for Defence), Hansard, HofC Written Answers to Questions, Defence: Sovereignty: Scotland, 4 July 2012, c680W.

the referendum takes place.[6] This suggests that there have also been few, if any, official preparations made for any negotiations between HM Government and the Scottish Government in the period immediately after the referendum either, regarding the 'next steps' in the constitutional relationship between Scotland and RUK.

0.7. The current debate is thus missing rigorous analysis in several key respects. In the discussions that have taken place so far, the sense of why Scotland is choosing to consider the option of independence has become drowned out, and a deeper appreciation of the macro political and economic constraints on its future prevented, by the concentration on highly selective technical debates. Assessments of, and principled preparations for, the vital arrangements for the timing and process of transition to the new fiscal settlement have been sidelined by the refusal of HM Government to engage with its Scottish counterparts on the details of the independence debate.

0.8. Work also remains to be done on Scotland's fiscal trajectory after its constitutional identity has been finalised, as regards further internal restructuring of governance and innovation in its fiscal policy decisions, although this is starting to be addressed by the Scottish Government's Fiscal Commission Working Group. And overarching the whole discussion lies the question of Scotland's international position, including increasingly fraught arguments over Scotland's acquisition or retention of European Union membership.

0.9. The lack of analysis has created a vicious circle of uncertainty and ignorance between policymakers and researchers in all areas of the independence question. With the exception of the SNP and Liberal Democrats to some degree, the main political parties represented at Westminster and Holyrood have not yet formulated or officially adopted a detailed position on what the solution for Scotland should be.

0.10. In part, their hands are somewhat tied by the dearth of rigorous, independent analysis of the necessary complexities of Scottish separation from the Union. But at the same time, the researchers and experts who would provide this analysis lack the guidance and direction they need from the political élite to determine how to choose and prioritise areas of research within the broader constitutional question.[7]

0.11. As far as considering how Scotland' disengagement should be 'done', "only the [Scottish and UK] governments can supply the answers".[8] Since this is exactly what the two relevant UK authorities are so far unwilling, or unable, to do, plans for putting into effect a potential vote for independence remain speculative, vague, and *ad hoc*. At the moment, the major stakeholders in the autonomy debate are waiting on a lead to be given by both governments—the Scottish Government's White Paper on what independence would mean in practice, due in November 2013, and the UK Government's programme of work assessing the benefits of Scotland remaining in the UK.[9]

0.12. The effects of this uncertainty are mainly falling on individuals, businesses, and communities in Scotland, and to some degree the wider UK. The lack of focused evidence and clear preparation for the eventuality of Scottish independence means that these groups are not receiving the guidance they would need to adequately deal with the effects of a transition.[10] 37% of Scottish businesses have claimed that they do not know enough about the consequences of independence to decide how to vote.[11] Further, barely 25% of UK businesses have started to make unilateral contingency plans in case of a 'Yes' vote, or even to consider the impact of Scottish independence on their operations—which may include transferring operations between Scotland and RUK, and internal payroll complications over the re-categorisation of their employees.[12]

0.13. Unless this changes, the UK and Scottish governments run the risk of inflating the organisational failures, delays, and administrative waste which are likely to accompany the move to independence. This risk is also contributing to a growing climate of doubt and scepticism in popular views of the independence debate:

[6] 'Scottish independence: Moore rejects pre-referendum negotiations', *BBC News*, 14 January 2013.
[7] I owe this point to a discussion with the late Lord Rees-Mogg. *Interview*, 23 October 2012.
[8] Bill Sinton (Clerk, House of Lords Economic Affairs Committee), *Interview*, 8 November 2012.
[9] Scottish Government, *Your Scotland, Your Referendum* (2012), p.14; Michael Moore MP (former Secretary of State for Scotland), Hansard, HofC Oral Answers to Questions, Scotland: Scottish Independence, 20 June 2012, c843.
[10] Peter Jones, 'Money union plan takes a pounding', *Scotsman*, 25 June 2013.
[11] David Ross, 'Firms admit to "independence uncertainty"', *Herald*, 1 July 2013; 'Majority not ready for referendum', *Herald*, 22 July 2013.
[12] *BQ Magazine*, 'Scottish independence "bad for business"', 7 December 2012; Lindsay McIntosh, 'Foreign fears over future Scottish currency "are hurting small businesses"', *Times*, 19 July 2013.

while support for the Union continues to outstrip support for independence, it is the 'don't know' polling contingent that is steadily on the increase (up to 24% of sampled voters in January 2013).[13]

0.14. With the referendum date and question finalised, public demand is rising for a detailed assessment of the implications of the referendum outcomes on Scotland's future. In the words of the Electoral Commission:

> We recommend that the UK and Scottish Governments should clarify what process will follow the referendum in sufficient detail to inform people what will happen if most voters vote 'Yes' and what will happen if most voters vote 'No'.
>
> We recommend that both Governments should agree a joint position, if possible, so that voters have access to agreed information about what would follow the referendum. The alternative—two different explanations—could cause confusion for voters rather than make things clearer.[14]

Dedicated consultation and research is slowly starting to emerge on such topics as the military arrangements after independence (including the future of Trident), and the wider macroeconomic health of an independent Scotland (and, by extension, RUK).[15]

0.15. The priority for the All-Party Parliamentary Taxation Group is thus to contribute a focused, observational, clarificatory view to the debate regarding the detailed arrangements for Scottish fiscal autonomy before and after the independence referendum. The APPTG is scrupulously cross-partisan, and will not take a stance on the moral, constitutional, or practical merits of independence, *tout court* or relative to alternative constitutional settlements that could ensue from a 'No' vote.

0.16. Instead, this project is intended to warn against and help mitigate the problems which the informational paucity of the debate is currently storing up for any period of structural 'loosening' between Westminster and Holyrood. It will offer both a critical appraisal of the current state of preparations for independence, and procedural and principled suggestions for how Scotland could best implement and benefit from fiscal autonomy.

0.17. This report—*Achieving Autonomy: What the independence referendum means for Scotland's fiscal future*—sets out to provide a framework for future research on Scottish fiscal autonomy. Work still needs to be done on the process of transition to any arrangement that gives Scotland more autonomy: policymakers and parties affected by independence need a roadmap to help guide them through future negotiations, and offer a view of Scotland's capacity for public-sector innovation and streamlining. On this basis, this report offers an examination of the various possible outcomes of the referendum, and an appraisal of their implications for Scotland's future status—globally, at a European level, and within the British Isles.

0.18. The structure of the report is as follows: Chapter 1 gives a brief account of the international parallels to, and historical development of, the contemporary debate around greater Scottish autonomy subsumed into the independence campaign.

0.19. Chapters 2 and 3 outline the current state of Scottish fiscal empowerment, examining the original Scotland Act 1998, the recommendations of the Calman Commission, and the ongoing implementation of the Scotland Act 2012.

0.20. Chapters 4 to 8 give a detailed discussion of four possible scenarios that may result from the voting results in the 2014 referendum, and the negotiations that will take place afterwards, in terms of Scotland's substantive fiscal empowerment.

0.21. Chapter 9 assesses these scenarios as lying on a theoretical continuum of devolution between unitary government and secession, but converging on a narrow substantive midpoint due to exogenous structural constraints in practice. Chapters 10 and 11 offer some conclusions and recommendations to be borne in mind in independence discussions in future.

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[13] 'Scottish independence: Poll blow for Yes campaign as independence support stalls', *Scotsman*, 14 January 2013; 'Pro-union campaign backers hail poll findings', *Herald*, 15 January 2013; Scott Macnab, 'Scottish independence: 44% still undecided', *Scotsman*, 15 August 2013.

[14] Electoral Commission, *Referendum on independence for Scotland*, p.36.

[15] See Stuart Crawford and Richard Marsh, *A' the Blue Bonnets: Defending an Independent Scotland* (London: RUSI, 2012); House of Lords Economic Affairs Committee, *The Economic Implications for the United Kingdom of Scottish Independence* (2013).

1. The emergence of the debate on Scottish autonomy

1.1. The current debate about the status of Scotland within, or outside, the Union cannot be considered in isolation. Questions about the extent of control Scottish institutions wield over issues that only, or predominantly, affect Scotland have formed a significant part of the UK's constitutional concerns over several decades—similar in persistence, if not in urgency, to the perennial questions about the status of Northern Ireland. This chapter thus situates the latest round of the independence debate in its wider context. First, it looks at the current spate of localist, nationalist, regionalist, and secessionist trends that have emerged in Europe in recent years, especially since the start of the ongoing economic crises. Second, it traces the historical background of calls for Home Rule, greater autonomy, and independence for Scotland, and assesses the constraints the past trajectory of the debate places on the future directions Scotland may take.

The international context

1.2. The Scottish independence debate and the referendum in 2014 have coincided with a time of wider significant upheavals in questions of sovereignty across Europe, triggered to a large extent by the economic crisis that has persisted since 2007. The UK as a political unit is far from unique in experiencing pronounced tensions between 'centre' and 'periphery', and the questions the issue of Scottish independence is raising about the right, or optimal, location and extent of 'coverage' for executive and legislative branches of governance within the UK are being echoed in other states and sub-national units as well.

1.3. It is worth providing a brief cross-sectional assessment here of current developments in parallel autonomist and secessionist movements in Europe, and the exact nature of the federal, consociational, and devolved solutions being considered for them. **It is the APPTG's view that the national and sub-national conversations taking place over the regions concerned could both productively inform, and benefit from, the debate on Scotland's future**.[16]

1.4. Perhaps the closest parallel to Scotland is the intricate series of nationalist and regionalist tendencies in the Spanish system, including those in the Basque Country and Galicia, but in particular the recent calls for independence in Catalonia.[17] In part, the recent flare-up in Catalan nationalism—marked by demonstrations and informal local independence micro-referenda—has stemmed from protracted legal disputes about the constitutionality of parts of the 2006 Statute of Autonomy of Catalonia.[18]

1.5. One of the key points of dispute concerns the articles in the Statue giving the Catalan Generalitat the "legislative capacity to establish and control their own taxes to local governments" (art. 218.2) and making Catalonia's obligation to guarantee the principle of fiscal "levelling and solidarity between regions" conditional on the other Autonomous Communities' "carry[ing] out a similar fiscal effort" (art. 206.3), both of which were declared unconstitutional by the Constitutional Court. The result has been a view in Catalonia that the Spanish tax-and-transfer system is decidedly asymmetric and disadvantageous towards the region, which represents 19% of Spain's overall economic output.[19]

1.6. At the same time, centre-periphery tensions have been stoked by the negotiations over bailouts from the Spanish government for a growing number of its regions, which are indebted to a combined total of €145bn.[20] The Spanish government was forced to set up an emergency €18bn regional bailout fund, from which Murcia and Galicia have already had to claim. In late August 2012, the government of Spain's richest

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[16] 'Catalonia's "unrequited love" for Caledonia', *BBC News*, 26 November 2012.
[17] 'Catalonia joins Scotland in push for 2014 independence vote', *Guardian*, 13 December 2012; 'Catalan leader Mas urges separatism in New Year speech', *BBC News*, 31 December 2012.
[18] Fiona Govan, 'Catalonia holds referendums to push for independence from Spain', *Telegraph*, 11 December 2009; Sarah Rainsford, 'Catalonia votes on independence from Spain', *BBC News*, 12 December 2009.
[19] OECD, *Reviews of Regional Innovation: Catalonia, Spain—Assessment and Recommendations* (2010), p.2.
[20] 'Debt crisis: Spanish bailout fears escalate as Catalonia eyes rescue', *Telegraph*, 24 July 2012; 'Catalonia's €bn plea brings Spanish bailout nearer', *Guardian*, 28 August 2012.

region, Catalonia, which by the end of 2012 had a debt alone of nearly €51bn, or 25.9% of Catalan GDP, was forced to request a €5bn bailout from the central government, yet added the caveat that it would not accept "political conditions" attached to the loan beyond the stringent austerity measures already imposed by the centre on the regions.[21]

1.7. The reaction from Madrid has been overwhelmingly negative, with particular objections voiced to the perception that the more autonomous regions were having their special constitutional privileges funded by taxpayers in more centre-dependent regions, and concern that the past profligacy of the regional governments would force Spain as a whole to seek a further tranche of aid from the European Stability Mechanism.[22] The aggressive reaction of the Spanish government has combined with discontent at the adverse social impact of centrally-imposed fiscal tightening to raise popular support for the suggestion that an independent Catalonia would achieve greater levels of prosperity than it could as an autonomous region within Spain.

1.8. The questions of prosperity, wealth, inter-regional solidarity, and ultimately economic sovereignty which characterise the independentist debates in Spain are echoed in several other European jurisdictions. One of the most prominent is the growing tendency towards Flemish nationalism in the already highly federalised Belgian polity: as of mid-2012, opinion polling suggested that over 50% of Flemish voters now support either the moderately pro-independence *Nieuw-Vlaamse Alliantie* (N-VA) or the radically secessionist *Vlaams Belang* (VB).[23] The question, again, concerns the perception of a wealthy region—Flanders—that it is being 'held back' or 'exploited' by a financially profligate, less economically viable region—Wallonia—through an opaque system of equalisation payments amounting to nearly 6% of Flemish GDP.[24]

1.9. The same situation applies to the tensions between the highly industrialised north ('Padania') and more agricultural south ('Mezzogiorno') of Italy, where a widening economic divide has raised support for autonomy or secession among northern voters, especially in Trentino-Südtirol, Veneto, Friuli-Venezia Giulia, and Lombardy, reflected in consistently high electoral support for the federalist *Lega Nord*.[25] And, although far less advanced, constitutional friction is growing in Germany over the 'solidarity surcharge' between the wealthy west (especially Baden-Württemberg and Bavaria) and relatively underdeveloped east (former GDR).[26]

1.10. These intra-national disputes, like the Scottish independence question, must also be seen within the wider context of Europe's constitutional future as a whole. The European Union is facing a concatenation of political and economic crises, both internal and external, which are pointing increasingly towards the need for a major reassessment of its overarching structure, and the relationship between its member states.[27] The sovereign debt crisis plaguing several of the less stable Eurozone economies, and the austerity measures designed to rebalance their internal organisation and performance, are threatening to drag the continent into a long-lasting uncompetitive slump.

1.11. In light of the financial transfers between states to prevent this, and the rising threats of emerging economies to European trade, growth, and living standards, the debate over European integration has taken central prominence. The dividing lines here lie between those who advocate greater harmonisation and empowerment of European-level institutions—a move from confederation to federation, and from monetary union to fiscal union as well—and those who prefer solutions where members retain, or receive back,

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[21] 'Catalonia seeks 5bn-euro bailout from Spain', *BBC News*, 28 August 2012; 'Catalonia asks for €5bn bailout from Spain', *Telegraph*, 28 August 2012; 'The Catalan Government posts a debt of €50.95 billion at the end of 2012', *Catalan News Agency*, 14 March 2013.

[22] 'El president de la Rioja, sobre el rescat català: "S'ha de tenir molta cara dura per demanar i després tenir el que em dóna la gana, com televisió i ambaixades"', *ara.cat*, 30 August 2012; 'Feijóo: "Avui paga Galícia i Catalunya demana"', *324.cat*, 2 October 2012.

[23] 'Opinion poll shows pro-independence parties could win an overall majority in Flanders', *nationalia.info*, 17 May 2012.

[24] Erik Buyst, Geert Jennes, and Jo Reynaerts, 'Update van de berekening van de stromen van overheidsmiddelen tussen de gewesten voor het jaar 2007', *Vlaams Instituut voor Economie en Samenleving Beleidspaper 13* (2010); 'Geldstroom naar Wallonië bereikt recordhoogte', *nieuwsblad.be*, 21 October 2004; 'Vlaanderen en Wallonië zijn beter af zonder transfers', *trends.be*, 5 May 2010.

[25] 'Sondaggi GPG: Quesiti/2 – Maggio 2011', *scenaripolitici.com*, 25 May 2011; 'Gli italiani non credono nella Padania. Ma al Nord prevale il sì alla secessione', *affaritaliani.it*, 28 June 2010.

[26] 'IW fordert Abschaffung des "Solis"', *Kölner Stadt-Anzeiger*, 15 November 2008; 'Ungeliebter Zuschlag: Verfassungsrichter weisen Soli-Einspruch zurück', *Der Spiegel*, 23 September 2010.

[27] 'David Herdson asks: Is the Euro-crisis over?', *Political Betting*, 19 January 2013.

elements of their political and economic sovereignty so far ceded to the European tier—a withdrawal to a diplomatic alliance and free trade area.

1.12. The effect of these parallel developments across Europe is to give the question of Scottish independence an unavoidable international slant. The internal provisions and mechanisms for Scottish autonomy and secession which have emerged through the negotiations before the Edinburgh Agreement, and which would be determined in the negotiations that would follow a 'yes' vote, have been monitored carefully by Catalonia (among others).[28] The reason for this is that the Spanish Constitution formally forbids regions to become independent, so that Catalan secession would require similarly protracted rounds of bargaining and compromise between the central and devolved authorities.[29]

1.13. Further, the prospect of the creation of several new small (indebted) economies in Europe has fuelled an acrimonious legal debate over their accession to, or inheritance of, EU membership, with all the rights, responsibilities, advantages, and disadvantages this would entail for the citizens and institutions of new and existing member states. Though far from resolved, the outcome of this debate will significantly impact on the future political and economic trajectory of Scotland, Catalonia, and all the potential other new states concerned.[30]

The historical background to the independence debate

1.14. While cross-sectional comparisons of the Scottish situation with its equivalents in Europe are illustrative of a broader trend within European politics, it is equally important and instructive to bear in mind the historical development of the debate around Scottish autonomy. **The APPTG believes that drawing informed comparisons with past autonomy debates is vital to giving a sense of how the argument's dividing lines have shifted over time, and that an awareness of previous attempts to resolve the centre-periphery tension between London and Edinburgh could prove instructive to the trajectory of devolved policy after the referendum takes place.**[31]

1.15. The Scottish independence movement has its origins in the 19th-century debates over Home Rule for Ireland, when in 1853 elements of the Conservative and Liberal parties started to back the creation of a Scottish Assembly, in order to maintain a degree of constitutional parity between the various British nations. A first step in the direction of Scottish *Home Rule* was taken by the establishment of the post of Secretary of State for Scotland and the Scottish Office in 1885, but this was widely perceived as an inferior and inadequate offer compared to the equivalent proposals for Ireland outlined in the defeated First and Second Irish Home Rule Bills in 1886 and 1893.

1.16. A Scottish Home Rule Bill was eventually presented to Parliament in 1913—along with the (passed but never enacted) Irish Home Rule Act 1914—but its progress was stalled by World War 1, and subsequently the Easter Rising and Irish War of Independence, and Scottish autonomy declined as an immediate constitutional priority.

1.17. Popular support for devolution of power to Scotland, however, remained firmly present. The Scots National League, founded in 1921 and inspired by the approach of Sinn Féin, first mooted the more radical aim of Scottish *independence*, and in 1928 founded the National Party of Scotland as a campaign vehicle for this goal. In contrast to the National Party of Scotland's independentist tendency and links to the Labour party, the cause of Home Rule was advocated by the devolutionist Scottish Party, whose origins lay with former members of the Conservative party dissatisfied with the latter's flagging support for Scottish autonomy. In

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[28] 'Scottish independence day may be delayed if Scotland votes Yes', *Scotsman*, 16 January 2013.

[29] "La Constitución se fundamenta en la indisoluble unidad de la Nación española, patria común e indivisible de todos los españoles, y reconoce y garantiza el derecho a la autonomía de las nacionalidades y regiones que la integran y la solidaridad entre todas ellas." *Constitución española de 1978, Artículo 2.* See also 'Artur Mas' nationalist gamble is risky business for Catalonia', *Independent Blogs*, 23 November 2012.

[30] 'Nicola Sturgeon to clarify SNP's position on independent Scotland's membership of European Union', *Daily Record*, 13 December 2012.

[31] For a similar historically-informed approach to the question of Scotland's constitutional position, see Commission on Scottish Devolution, *The Future of Scottish Devolution within the Union: A First Report* (2008), pp. 7-10.

1934, these two parties merged into the Scottish National Party, which initially supported devolution but rapidly switched to supporting independence, not in the toxified form of undemocratic nationalism present in Europe at the time, but rather a liberal-democratic civic nationalism more in line with the British political tradition.

1.18. The modern impetus for Scottish independence began with the decline of the British Empire and decolonisation in the 1960s, which weakened the effect of popular imperialism in promoting the unionist tendency in Scottish politics. The collapse of the Scottish Unionist Party, and the sudden entry of the Scottish National Party into Westminster politics after the 1967 Hamilton by-election, returned the 'Scottish question' to national prominence. The response from the main Westminster parties was to initially acquiesce to moves towards devolution, the Conservatives via the 1968 Declaration of Perth, and Labour via the establishment of the Kilbrandon Commission (1969-73).

1.19. The Kilbrandon Commission was designed to examine the constitutional structure of the UK and the status of its constituent nations, with the aim of assessing whether independence, confederalism, federalism, or devolution should be pursued. The first three alternatives were rejected in favour of devolved, directly elected assemblies for Scotland and Wales, and some regional devolution to England (though two members of the commission published a Memorandum of Dissent advocating regional assemblies for England as well).[32]

1.20. The areas of responsibility recommended for devolution to Scotland were: education, the environment, health, home affairs, legal matters, and social services, while the proposed Scottish Assembly would be jointly responsible with the UK government for agriculture, fisheries, and food. Significantly, the Kilbrandon Commission did not recommend any degree of fiscal or other economic devolution for any of the devolved regions, reflecting the fact that the debate about Home Rule up to this point had been almost entirely concerned with principles of cultural difference and identity, and the questions of sovereignty and (limited) self-determination these entailed.

1.21. The economic—specifically, fiscal—dimension to the debate only emerged with any degree of significance after the discovery of North Sea oil reserves in the 1970s. The location of several of the largest oil fields—including Montrose, Forties, Brent, and Argyll (now Ardmore)—off the eastern Scottish coast prompted the SNP to pin their electoral strategy to the "It's Scotland's oil" campaign, stressing the important role the oil revenue could play in mitigating the adverse effects of deindustrialisation on the struggling Scottish economy. The SNP strategy was formidably successful: at the two general elections in 1974, the party's representation at Westminster rose to 7, and then to 11 seats, the latter on a 30% vote share within Scotland.[33]

1.22. The McCrone report on the viability of an independent Scotland, commissioned in 1974 but classified until a 2005 Freedom of Information request by the SNP, suggested that exclusive rights to a geographically-determined share of North Sea oil revenue would have given an unprecedented boost to the Scottish economy:

> It must be concluded therefore that large revenues and balance of payments gains would indeed accrue to a Scottish Government in the event of independence provided that steps were taken either by carried interest or by taxation to secure the Government 'take'. Undoubtedly this would banish any anxieties the Government might have had about its budgetary position or its balance of payments. The country would tend to be in chronic surplus to a quite embarrassing degree and its currency would become the hardest in Europe, with the exception perhaps of the Norwegian kroner. Just as deposed monarchs and African leaders have in the past used the Swiss franc as a haven of security, so now would the Scottish pound be seen as a good hedge against inflation and devaluation and the Scottish banks could expect to find themselves inundated with a speculative inflow of foreign funds.[34]

More controversially, the report also suggested that officials had advised government ministers on how best to exploit the new sources of revenue without allowing the pro-independence movement to capitalise on the

[32] Northern Ireland was omitted from consideration, as its status within the UK had already been addressed in the Northern Ireland Constitution Act 1973.
[33] 'UK General Election October 1974: Regional distribution of seats and percentage vote', *politicsresources.net*.
[34] Gavin McCrone, 'The Economics of Nationalism re-examined' (1974), p.8.

discovery as a pillar of Scottish sovereignty—i.e., finding the "most convincing way of taking the wind out of the SNP's sails".[35]

1.23. Even without the electoral boost of the findings of the McCrone report, the SNP were able to leverage their 'kingmaker' position in the context of the minuscule Labour majority after October 1974 and the Lib-Lab pact after 1977 into a deal to hold a referendum on devolution to Scotland. Despite differences within both the SNP and Labour over the merits of devolution as either an end-in-itself or a step on the way to full independence, the Scotland Act 1978 set in place the provision for a Scottish Assembly with very limited, specifically delineated powers, broadly influenced by the findings of the Kilbrandon Commission.

1.24. However, the post-legislative 1979 referendum to approve the Act passed so narrowly (52% to 48%) and on a sufficiently low turnout (63.6%) that the total 'Yes' votes failed to satisfy the minimum condition of 40% approval required for validity, and the Act was subsequently overturned. In retaliation for the technical failure of this first attempt to finally realise Scottish Home Rule, the SNP withdrew their support from the government, triggering a motion of no confidence, and the Conservative victory at the 1979 election.

1.25. Since the Conservatives under Thatcher had reversed their support for devolution articulated in the Declaration of Perth, the question of Scottish autonomy was temporarily placed in the suspended animation of theoretical consideration by the Opposition parties. Scottish Labour and SNP co-organised the Campaign for a Scottish Assembly in 1980, which evolved into the Scottish Constitutional Convention with the co-operation of the Scottish Liberal Democrats and minor Scottish parties (but not the Conservatives, who opposed devolution, or the SNP, who were dissatisfied at the exclusion of independence as an option), as well as churches, trades unions, and other civic groups, culminating in the publication of a commitment to "agree a scheme for an Assembly or Parliament for Scotland" in the form of the Claim of Right 1989.

1.26. The Claim of Right ultimately laid the foundation for the 1997 devolution referendum, held after the Labour election victory earlier that year, which asked voters *both* whether there should be a Scottish Parliament, *and* whether this Parliament should be granted tax-varying powers. With a clear majority for 'Yes' in both cases (74.3% to 25.7% for the Parliament's existence, 63.5% to 36.5% for its tax-varying powers), the referendum paved the way for the formulation of the Scotland Act 1998.

[35] McCrone, 'Economics of Nationalism re-examined', introductory letter; see also 'How black gold was hijacked: North sea oil and the betrayal of Scotland', *Independent*, 9 December 2005; 'Papers reveal oil fears over SNP', *BBC News*, 12 September 2005.

2. Scotland's fiscal *status quo*

2.1. Within the general contemporary and historical context of the Scottish Home Rule debate, the campaigns for and against Scottish independence are taking place within a specific constitutional, financial, and policy framework determined with the establishment of the Scottish Executive—now called the Scottish Government—by the Scotland Act 1998. This chapter examines the institutional background against which subsequent rounds of further empowerment of the Scottish policy are set, and discusses the analysis of the Calman Commission on the prospects for additional devolution from the UK to the Scottish governance tier.

The Scotland Act 1998

2.2. The 1997 devolution referendum and Scotland Act 1998—as with the respective referenda and statues for the other devolved regions—mark a key turning-point in the constitutional treatment of Scotland within the Union. Whereas the (failed) 1978 Act outlines the specific limited number of powers devolved to Scotland, such that the default locus of authority in cases of uncertainty still remains the central government at Westminster, the 1998 Act inverts this approach by explicitly stating the "reserved matters" over which Westminster retains control.[36]

2.3. The 1998 Act introduces formal mechanisms for reserved matters to be devolved if required, such that the default authority for all unstated cases becomes the devolved government at Holyrood:

> **30 Legislative competence: supplementary**
>
> (1) Schedule 5 (which defines reserved matters) shall have effect.
>
> (2) Her Majesty may by Order in Council make any modifications of Schedule 4 or 5 which She considers necessary or expedient.
>
> (3) Her Majesty may by Order in Council specify functions which are to be treated, for such purposes of this Act as may be specified, as being, or as not being, functions which are exercisable in or as regards Scotland.
>
> (4) An Order in Council under this section may also make such modifications of—
>
> (a) any enactment or prerogative instrument (including any enactment comprised in or made under this Act), or
>
> (b) any other instrument or document,
>
> as Her Majesty considers necessary or expedient in connection with other provision made by the Order.[37]

This "maximalist" statutory move vastly increases Scotland's political control, accountability, responsibility, and "legislative competence", with its only delimitation thus being the compatibility of its policies with Westminster's continued power to legislate in respect of Scotland via the principle of absolute Parliamentary sovereignty, with the consent of the Scottish Parliament under the terms of the Sewel Convention.[38]

2.4. This is of particular interest in the context of future developments in Scottish devolution, as the main focus of debate in the last 20 years has become the degree of economic, in particular fiscal, control devolved institutions can, and should, exercise. In light of the fiscal component of the 1997 devolution referendum, the 1998 Act devotes two Parts exclusively to delineating the specific fiscal arrangements for Scotland—on the financial provisions, which outline the formal mechanisms for funding the Scottish Government's budget, and on the tax-varying power, which mitigates the Act's stipulation that fiscal policy remain a "reserved matter" to the UK Parliament.

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[36] Scotland Act 1998 c. 46 Schedule 5; cf. Commission on Scottish Devolution, *Future of Scottish Devolution*, pp.37-8.
[37] Scotland Act 1998 c. 46 Section 30.
[38] Scotland Act 1998 c. 46 Section 28(7); cf. Commission on Scottish Devolution, *Future of Scottish Devolution*, pp.29, 38, 81-2.

2.5. The financial provisions consist in the creation of a Scottish Consolidated Fund, mirroring the UK Consolidated Fund, into which a block grant from the UK Parliament is paid. The result is that the *budgeting*, or *distribution*, of expenditure across all the areas of policy devolved to Holyrood—including health, education, justice, and local government—is left to be determined by the Scottish Government as it sees appropriate, with only the *aggregate amount* of expenditure within Scotland left to the authority of the UK Parliament, as stipulated by the Barnett formula.

2.6. The tax-varying power, which gives the Scottish Parliament the ability to vary income tax within Scotland by up to ±3p in the £, is the result of the emphasis placed on control over taxation in the negotiations over parliamentary control. The Scottish Variable Rate, or 'Tartan tax'—as the mechanism is known—is thus the primary 'shared competence' between Westminster and Holyrood delineated in the 1998 Act.

2.7. However, despite the degree of symbolic significance and practical importance which supporters of devolution accorded the provision of at least a minimal degree of fiscal control, Holyrood has yet to exercise its autonomous prerogative, even since the start of SNP dominance in 2007.[39] This is partly due to the direct link between the Scottish Variable Rate and the block grant paid by the UK into the Scottish Consolidated Fund: if the Scottish Government were to raise income tax, the additional amount paid by the UK to Scotland would increase, and if it were to lower it, the amount paid would be cut correspondingly.[40]

2.8. Under the current Barnett formula arrangements for the grant, Scotland enjoys c.120% the identifiable per capita expenditure on services relative to England (with figures of c.115% for Wales and c.130% for Northern Ireland), which has allowed the Scottish Government to retain more generous levels of expenditure on education, health, and welfare than is the case for equivalent policies in England (see Table 1.1).

Table 1.1: Total identifiable expenditure on services by country and region, per head 2006-07 to 2010-11[41]

£/head (outturn)	2006-07 (outturn)	2007-08 (outturn)	2008-09 (outturn)	2009-10 (outturn)	2010-11 (outturn)
England	7 042	7 414	7 962	8 553	8 634
Scotland	8 588	9 045	9 424	9 945	10 165
Wales	8 260	8 609	9 144	9 726	10 017
N. Ireland	8 963	9 540	10 044	10 550	10 668
UK total	7 288	7 671	8 203	8 785	8 888

2.9. Any economically significant drop in the Scottish income tax rate would jeopardise the Scottish Government's ability to sustain this expenditure, while any significant rise would—due to high labour mobility across the border to the RUK—risk draining the Scottish tax base of its more lucrative higher earners, and thus again potentially endanger fiscal commitments which Scottish citizens have come to take for granted.[42] The Scottish Variable Rate could raise at most £1.1bn, or c.4% of the Scottish Parliament's Budget, which would arguably be swamped by the administrative costs of introducing a change, and would probably be "insufficient either to meet economic needs or to provide an adequate degree of accountability or autonomy".[43]

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[39] Commission on Scottish Devolution, *Future of Scottish Devolution*, p.57.
[40] Scotland Act 1998 c. 46 Sections 77, 78.
[41] HM Treasury, *Public Expenditure Statistical Analyses 2012* (2013), p.119.
[42] Commission on Scottish Devolution, *Future of Scottish Devolution*, p.61.
[43] Ibid., p.62.

2.10. Yet this lack of proactivity towards implementing the 1998 Act's means for fiscal autonomy has not prevented subsequent moves being made towards strengthening Scotland's autonomous fiscal capabilities. In 2007, against the wishes of the SNP minority government, a Labour opposition motion in the Scottish Parliament, supported by the Scottish Conservatives and Liberal Democrats, established the Commission on Scottish Devolution, popularly known as the 'Calman Commission'. Its terms of reference were:

> To review the provisions of the Scotland Act 1998 in the light of experience and to recommend any changes to the present constitutional arrangements that would enable the Scottish Parliament to better serve the people of Scotland, that would improve the financial accountability of the Scottish Parliament and that would continue to secure the position of Scotland within the United Kingdom.[44]

The SNP's opposition to the motion, and attempt to subsume the Commission's intended subject-matter into the ongoing National Conversation on independence, stemmed from the motion's explicit intent to find solutions compatible with Scotland remaining "an integral and distinctive part of the United Kingdom"—i.e., *within* the Union.[45]

2.11. Just as with the 1980s Scottish Constitutional Convention, the SNP objected to the "Calman parties'" refusal for the more radical options associated with full independence to even be considered. As such, again, this deliberate constraint on the Calman Commission's parameters touched on the unresolved split tendency within the SNP over the merits of further stages of devolution. The SNP remain as torn as before the 1979 referendum on the question of whether ever greater devolution should be pursued as a way of incrementally approaching independence, or whether doing so would risk dampening public enthusiasm for complete constitutional separation.[46] It is, in part, the purpose of this report, and the APPTG's wider project, to finesse the accuracy of these competing perceptions.

The recommendations of the Calman Commission

2.12. The Calman Commission released its first, interim, report in 2008, which concluded that the "very significant constitutional development" of Scottish devolution was "in practice operating successfully".[47] It found that the devolved institutions had "established themselves in Scottish life, and [were] widely valued by Scots", to the extent that "some groups [who] had initially been sceptical about the value of a Scottish Parliament […] now strongly supported it because of the benefits it brought to their members".[48] Though designed mostly as an overview of the *status quo* post-1998 of devolved governance in Scotland, and as a "platform" for firmer, forward-looking recommendations in the final report, the first report already identified some significant points of tension in the fiscal relationship between Scotland and the UK.

2.13. In particular, it highlighted the incompatibility between attempts to promote and encourage variation in taxation and public spending between regions and the maintenance of a "social Union" at the British level, and on that basis ruled full fiscal autonomy out at this stage of devolution:[49]

> [T]o the extent that a region with full fiscal autonomy is to all intents and purposes independent, full fiscal autonomy is not consistent with the maintenance of the Union[.][50]

This implies that the various possible stages of devolution from unitary centralism to outright secession are not as fluid, gradualist, or equilibrated in practice as in theory. Some combinations of devolved and reserved powers are practically unstable, or unworkable, which means that discrete choices will need to be made regarding the fiscal 'direction' in which Scotland wants to go—whether as a UK region or a separate country.

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[44] Scottish Parliament, Motion S3M-00976: Wendy Alexander, Paisley North, Scottish Labour, Date Lodged: 04/12/2007; see also Commission on Scottish Devolution, 'An approach to the task', 28 April 2008.
[45] Commission on Scottish Devolution, *Future of Scottish Devolution*, p.27; 'SNP accused of failing to embrace Calman Commission recommendations', *Daily Record*, 25 June 2009.
[46] Michael Kelly, 'SNP's apparent calm masks divisions', *Scotsman*, 1 August 2013.
[47] Commission on Scottish Devolution, *Future of Scottish Devolution*, p.26.
[48] Ibid., pp.25-6.
[49] 'Full Scots fiscal power ruled out', *BBC News*, 2 December 2008.
[50] Commission on Scottish Devolution, *Future of Scottish Devolution*, p.64.

2.14. The Calman Commission's First Report also made clear that this choice of 'direction' would have to include a direct engagement with Scotland's overarching fiscal position—i.e., the "balance between taxation and public spending in Scotland".[51] In seeking to alter the balance of funding instruments—tax assignment, grants from central government, or fiscal autonomy[52]—for the devolved Scottish institutions, the Commission argued that governmental objectives regarding social security and welfare provision would be a significant driver of the extent of autonomy Scotland could be granted:

> [I]f devolution within the Union is on the basis of a high degree of commitment to a broad common understanding of the welfare state, and so a common social citizenship, then the mix of funding instruments used might be expected to be weighted towards grant ... [I]f there was a greater desire to allow autonomy on welfare issues, power over taxation would be devolved to the maximum practical extent.[53]

2.15. In other words, no analysis of the fiscal options for Scotland can be complete without some view of the policy end-goal which reforms of the relationship between Holyrood and Westminster are intended to achieve—a positive project, or guiding view, which characterises *what kind of society* the political-economic entity of Scotland is meant to become.[54] The Commission was explicitly careful to "at this stage make[] no judgement about what point on this spectrum [from grant-reliance to autonomy] is appropriate and therefore what balance amongst funding mechanisms is best for Scotland".

2.16. **However, it is the APPTG's view that this attitude *can no longer be sustained* so close to the referendum. Given the growing pressure for public discussion of what the various choices for Scotland are, views of Scotland-after-'Yes' and Scotland-after-'No'—especially from the Scottish and UK Governments—to concretise arguments on both sides of the debate have become extremely necessary.**[55] This move has already been pre-empted by the recent foundation of the Common Weal group of academics and economics, designed to flesh out a Scandinavian model of Scottish political economy, and by the book *Scotland's Road to Socialism*, which outlines an explicitly left-wing approach to greater autonomy from the UK.[56] The APPTG's view of 'what Scotland should look like' will be discussed further in a future report.

2.17. The Calman Commission's second, and final, report in 2009 can thus be seen as one attempt to pick out one "practicable" option from the "range of points on [the fiscal-devolution] spectrum", namely one "consistent with [the Commission's] vision of the Union"[57]. Its fiscal recommendations were designed to "give the Scottish Parliament real financial accountability [...] in a way which will neither disrupt the economic Union between Scotland and the rest of the United Kingdom nor break the bonds of common social citizenship which we describe as the social Union".[58] The Commission thus erred on the side of caution—or constitutional conservatism—wherever a proposal for a devolved tax or spending power threatened to incite instability or volatility within the existing arrangements, on the basis that this would defy the "ultimate purpose of devolution", namely to "make life better for the people of Scotland".[59]

2.18. To achieve its aim of improving the Scottish Parliament's financial accountability, the Commission recommended various ways to move away from central government grants as a means of funding the Parliament's Budget. For some taxes, especially 'green' and geographically-contingent taxes, the recommendation was for a straight switch to Scottish fiscal control:

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[51] Ibid., p.60.
[52] Ibid., p.63.
[53] Ibid., p.68.
[54] Brian Monteith, 'Questioning future isn't negative', *Scotsman*, 15 July 2013.
[55] 'We need to talk about what's going to happen AFTER the referendum', *Scottish Sun*, 4 February 2013; 'Willie Rennie: We must realise future is federal', *Scotsman*, 3 February 2013; George Kerevan, 'Dare to set out a vision, First Minister', *Scotsman*, 26 July 2013; George Kerevan, 'My blueprint for independence', *Scotsman*, 2 August 2013; Michael Kelly, 'An all or nothing independence vote', *Scotsman*, 8 August 2013; Alex Massie, 'Time to think big on independence', *Scotsman*, 12 July 2013.
[56] Tom Gordon, 'The Common Weal: how Scotland could look very different after indyref', *Herald*, 17 June 2013; Tom Gordon, 'Jimmy Reid's legacy climbs up independence agenda', *Herald*, 14 July 2013; 'Scottish independence: Scotland's Road to Socialism', *Scotsman*, 29 May 2013; Alex Massie, 'Nostalgia is undoing of Scottish Left', *Scotsman*, 28 August 2013.
[57] Commission on Scottish Devolution, *Future of Scottish Devolution*, p.69.
[58] Commission on Scottish Devolution, *Serving Scotland Better: Scotland and the United Kingdom in the 21st Century* (2009), p.112.
[59] Ibid., p.29.

> RECOMMENDATION 3.2: Stamp Duty Land Tax, Aggregates Levy, Landfill Tax and Air Passenger Duty should be devolved to the Scottish Parliament, again with a corresponding reduction in the block grant.[60]

Though a symbolically significant step, autonomy over these taxes is financially somewhat minor: these four taxes and duties together account for only £868m, or 1.9% of Scotland's current non-North Sea revenue.[61]

2.19. For the altogether more financially weighty matter of income tax, which at £10.8bn, or 23.3% of revenue,[62] is by far the most important fiscal lever available to either government in Scotland, the Commission suggested a mixed approach of limited fiscal autonomy, tax assignment, and continuation of the central grant as a result of the reservation of some matters to Westminster:

> RECOMMENDATION 3.1: Part of the Budget of the Scottish Parliament should now be found from devolved taxation under its control rather than from grant from the UK Parliament. The main means of achieving this should be by the UK and Scottish Parliaments sharing the yield of income tax.
>
> a. Therefore the Scottish Variable Rate of income tax should be replaced by a new Scottish rate of income tax, collected by HMRC, which should apply to the basic and higher rates of income tax.
>
> b. To make this possible, the basic and higher rates of income tax levied by the UK Government in Scotland should be reduced by 10 pence in the pound and the block grant from the UK to the Scottish Parliament should be reduced accordingly.
>
> c. Income tax on savings and distributions should not be devolved to the Scottish Parliament, but half of the yield should be assigned to the Scottish Parliament's Budget, with a corresponding reduction in block grant.
>
> d. The structure of the income tax system, including the bands, allowances and thresholds should remain entirely the responsibility of the UK Parliament.[63]

2.20. The final point—the explicit refusal to devolve the power to vary the tax bands, allowances, and thresholds—is a severe constraint on any possibility for meaningful (income) tax competition within the UK. This implies that the concern to preserve the 'social Union' is seen as trumping the potential *benefits* of fiscal competition within the UK,[64] which means that the 'Calman vision' for *devolution* was at a significant remove from the more 'experimental' and competitive forms of *federalism* present in, or explored by, the US and French systems (for example). The result is that the Scottish conception of social justice and the welfare state—a significant part of 'what Scotland should look like'—is *currently* still very much premised on the form and structure of the prevailing UK 'system', and there is not yet scope for Scotland to develop its own direction in this regard.

2.21. The Commission acknowledged the continued need—in light of the aspiration to a 'social Union' across the UK—for a central grant element to funding for Scotland, but remained largely silent in response to the widespread calls for the reassessment and reform of the Barnett formula by which this grant is calculated:

> RECOMMENDATION 3.4: The block grant, as the means of financing most associated with equity, should continue to make up the remainder of the Scottish Parliament's Budget but it should be justified by need. Until such times as a proper assessment of relative spending need across the UK is carried out, the Barnett formula, should continue to be used as the basis for calculating the proportionately reduced block grant.[65]

2.22. Finally, despite initial scepticism about the feasibility of devolving extensive capital borrowing, the Commission gave a cautious green light to an expansion of the Scottish Government's short- and long-term borrowing powers. The intention was to increase the Scottish Parliament's financial autonomy, as much by mitigating its "dependence on uncertain flows of revenue" and "allow[ing] a consistent profile of spending",

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[60] Ibid., p.111.
[61] Scottish Government, *Government Expenditure and Revenue Scotland 2011-12* (2013), p.30.
[62] Ibid., p.30.
[63] Commission on Scottish Devolution, *Serving Scotland Better*, p.111.
[64] 2020 Tax Commission, *The Single Income Tax: Final Report* (2012), p.366.
[65] Commission on Scottish Devolution, *Serving Scotland Better*, p.111.

as by bypassing its inability to negotiate its budget with HM Treasury and "allowing it some choice over the time at which those investments are made".[66]

> RECOMMENDATION 3.7: The Scottish Ministers should be given additional borrowing powers:
>
> a. The existing power for Scottish Ministers to borrow for short term purposes should be used to manage cash flow when devolved taxes are used. Consideration should be given to using the power in the Scotland Act to increase the limit on it if need be.
>
> b. Scottish Ministers should be given an additional power to borrow to increase capital investment in any one year. There should be an overall limit to such borrowing, similar to the Prudential regime for local authorities. The amount allowed should take account of capacity to repay debt based on future tax and other receipts. Borrowing should be from the National Loans Fund or Public Works Loans Board.[67]

2.23. The primary logic for this recommendation was that "[f]iscal autonomy produces relatively low predictability in resources for spending, and so it is likely to require borrowing capacity to smooth over fluctuations in revenues".[68] The Commission rejected, however, any ability for Scottish institutions to "borrow[] over the economic cycle to finance current or revenue expenditure", as this would conflict with the "macro economic policy responsibilities of the UK Government" and give Scotland the "scope to scope to attempt to run a separate macro-economic policy from the rest of the UK", which would again serve to undermine the ideal of the 'social Union'.[69]

2.24. At the same time, the Commission emphasised the "need for a system for fiscal co-ordination inside the country, so that economic aggregates can be managed"—in other words, to "ensure that overall economic management responsibilities can be discharged, and to involve the Scottish Parliament and Government more closely with the UK institutions responsible for economic management".[70] The need for a form of intergovernmental co-ordination mechanism between HM Treasury and the devolved institutions, given Scotland's continued reliance on the UK tier as its ultimate source of funding, has become all the more pressing since the Calman Commission's report, in light of (for instance) the adverse effect on Spanish national debt of overextended borrowing by the more autonomous of its constituent regions.

2.25. One of the notable, and contentious, omissions from the taxes which the Commission recommended for devolution to Scotland was *corporation tax*. Several of the submissions of evidence to the Commission emphasised the volatility of corporation tax receipts, which would have prompted a need for more substantial short-term borrowing powers to compensate for greater expected differences between revenue and expenditure.[71] The Commission also accepted *en gros* the rejection by its Independent Expert Group of corporation tax as a "candidate" for either devolution *or* tax assignment on the basis of likely—albeit constrained—distortionary and wasteful effects of tax competition within the UK (including tax avoidance), and administrative costs for UK firms:

> We recognise that devolving corporation tax would represent a shift in increasing the financial accountability of the Scottish Parliament, although arguably other taxes have a closer connection to the electorate. In terms of answering the specific consultation question, we think the scope for substantive reductions in the possible rate of corporation tax in Scotland are limited if it is desired to maintain comparable levels of public services, unless the Scottish Government is able to increase revenues from other sources. That is to say, we are not convinced that allowing the Scottish Parliament to determine a Scottish rate of corporation tax would produce harmful tax competition because the scope to vary the rate is, in effect, constrained. Even so, the potential for differing rates of corporation tax across the UK would create economic inefficiencies as firms react to tax considerations rather than commercial factors. We also think the potential administrative impacts of such a move are significant.[72]

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[66] Commission on Scottish Devolution, *Future of Scottish Devolution*, p.73; Commission on Scottish Devolution, *Serving Scotland Better*, p.107.
[67] Commission on Scottish Devolution, *Serving Scotland Better*, p.112.
[68] Commission on Scottish Devolution, *Future of Scottish Devolution*, p.64.
[69] Commission on Scottish Devolution, *Serving Scotland Better*, pp.107-8.
[70] Commission on Scottish Devolution, *Future of Scottish Devolution*, pp.64, 66.
[71] Commission on Scottish Devolution, *Serving Scotland Better*, pp.82, 95.
[72] Ibid., pp.94, 263.

2.26. Corporation tax was also seen as a tax that is less *integral* to the creation of a functioning Scottish policy on the basis that it does not manifest a "direct connection with the population" in the same way as, for instance, income tax: with income tax, "although not all voters are taxpayers, almost all taxpayers will be voters"—a relationship which simply does not hold as strongly with corporation tax or, for that matter, fuel duties.[73] **As an obvious component of further devolution settlements, and a significant matter in possible Scottish independence, corporation tax will be a subject of particular analysis in later chapters.**

[73] Ibid., p.102.

3. The Scotland Act 2012

3.1. The Calman Commission's recommendations were largely transferred without amendment into the 2009 white paper that formed the foundation of the 2010 Scotland Bill, which was eventually passed as the Scotland Act 2012. However, technical implementation of the 2012 Act will not be complete until 2016, so its full effects will not be felt until several years after the independence referendum. This chapter assesses the additional changes that will be introduced above and beyond the autonomy granted to Scotland by the 1998 Act, and the ongoing timetable for their implementation, in terms of the foundation they provide for future moves towards Scotland's further fiscal empowerment.

The effects of the Scotland Act 2012

3.2. The Scotland Act 2012's passage was briefly delayed by the Scottish Government's refusal to pass a legislative consent motion for the proposed Bill, due to the inclusion of provisions for Westminster to take back powers in some areas of licensing and regulation in order to achieve a "consistent approach" across the UK.[74] After the two Governments reached an agreement in March 2012 for these plans to take back powers to be removed, the legislative consent motion was passed in April, and the Bill was enacted as a new Scotland Act in May.[75]

3.3. From the fiscal perspective, the only significant omission was the decision on the part of UK ministers to retain control of air passenger duty and the aggregates levy at Westminster, rather than devolve them to Holyrood—although, in light of recent plans to devolve air passenger duty to the Northern Ireland Assembly, and current campaigns for the duty to be abolished entirely, this omission might soon be remedied, or rendered moot.[76]

3.4. In the financial provisions of the Act, the first and most prominent is the replacement of the Scottish Variable Rate with the separate Scottish rate of income tax (SRIT):

> **26 Income tax for Scottish taxpayers**
>
> (1) The Income Tax Act 2007 is amended as follows.
>
> (2) In section 6 (the rates of income tax) after subsection (2) insert—
>
> "(2A) Subsection (2) does not apply to the non-savings income of a Scottish taxpayer.
>
> (2B) The basic rate, higher rate and additional rate for a tax year on the non-savings income of a Scottish taxpayer is to be found as follows.
>
> *Step 1* Take the basic rate, higher rate or additional rate determined as such under subsection (2).
>
> *Step 2* Deduct 10 percentage points.
>
> *Step 3* Add the Scottish rate (if any) set by the Scottish Parliament for that year."
>
> [...]
>
> (3) In section 10 (income charged at particular rates: individuals) after subsection (3A) insert—
>
> "(3B) If the individual is a Scottish taxpayer, the basic rate, higher rate and additional rate are—
>
> (a) on so much of the individual's income as is savings income, the rates determined as such under section 6(2);

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[74] 'UK government plans new Scottish Parliament powers', *BBC News*, 25 November 2009.

[75] 'Holyrood to be given new income tax and borrowing powers', *BBC News*, 21 March 2012; 'MSPs endorse new Holyrood powers under Scotland Bill', *BBC News*, 18 April 2012; 'MPs approve new Holyrood powers under Scotland Bill', *BBC News*, 26 April 2012.

[76] HM Revenue & Customs, *Air Passenger Duty (APD): Devolution of rates to Northern Ireland* (2012); Scottish National Party, 'UK devolution double standards over APD', 21 February 2012; 'Scrapping Air Passenger Duty "would create 60,000 jobs"', *Telegraph*, 4 February 2013.

(b) on so much of the individual's income as is not savings income, the rates determined as such under section 6(2B)."[77]

3.5. Perhaps the most significant effect of these provisions for the Scottish rate of income tax is their contribution to the growing legal separation between Scottish and RUK residents, citizens, or taxpayers. With wholly different education and legal systems, and separate healthcare administration, the Scottish 'experience of being British' is slowly being structurally divorced from the equivalent for other regions of the UK. **The APPTG suggests that the effects of this will mean that the implications of independence in terms of the legal/fiscal treatment of Scottish residents will not be especially dramatic: the mechanisms needed to take on the administrative burden in Scotland (and in the RUK) will already be in place, allowing for a 'smoother transition' to independence.**

3.6. The second and third provisions, the separate Scottish Land and Buildings Transaction Tax (LBTT) and Landfill Tax, are dealt with by inserting the following sections into the 1998 Act:

> **80I Tax on transactions involving interests in land**
>
> (1) A tax charged on any of the following transactions is a devolved tax—
>
> (a) the acquisition of an estate, interest, right or power in or over land in Scotland;
>
> (b) the acquisition of the benefit of an obligation, restriction or condition affecting the value of any such estate, interest, right or power.
>
> (2) The tax may be chargeable—
>
> (a) whether or not there is any instrument effecting the transaction,
>
> (b) if there is such an instrument, regardless of where it is executed, and
>
> (c) regardless of where any party to the transaction is or is resident.[78]

and

> **80K Tax on disposals to landfill**
>
> (1) A tax charged on disposals to landfill made in Scotland is a devolved tax.
>
> (2) A disposal is a disposal to landfill if—
>
> (a) it is a disposal of material as waste, and
>
> (b) it is made by way of landfill.[79]

3.7. Both are fairly straightforward and self-explanatory legislative amendments, and offer an obvious blueprint for how further fiscal powers might be transferred to the Scottish Government in practice in future. In both cases, the relevant parts of the equivalent existing national legislation—the Finance Act 2003 (stamp duty land tax) and Finance Act 1996 (landfill tax)—are subjected to "disapplication", with references to the United Kingdom replaced with "England and Wales or Northern Ireland".

3.8. But while the abstract capacity for fiscal autonomy in these areas is now created, there has been no indication of the future rates of LBTT and Landfill Tax, apart from some illustrative examples in the Scottish Government's consultation documents. John Swinney MSP, the Scottish Government's Cabinet Secretary for Finance, has indicated that rates for these taxes will be announced in the draft Scottish budget for 2015-16 in autumn 2014. However, this means that it will still be unclear before the referendum whether it would be advantageous to perform transactions covered by LBTT *now* or under a *future* independent Scottish tax régime. In the absence of the requisite information to allow individuals, businesses, and communities to engage in meaningful forward planning, the effect of this new empowerment has been to cast uncertainty over the future trajectory of tax levels in these two policy areas. The two taxes thus offer a microcosmic example of the problem greater fiscal empowerment for Scotland faces regarding uncertainty over policy changes due to decentralisation of power from Westminster, reinforcing that point that, for a "proper debate" over greater fiscal autonomy to be had, it must include concrete details about future tax policy.[80]

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[77] Scotland Act 2012 c. 11 Section 26.
[78] Ibid., Section 28(1).
[79] Ibid., Section 30(1).
[80] Richard Brunton (Tax Manager, HJB Gateley), *Interview*, 14 November 2012.

3.9. Most relevantly for the APPTG's interest in the timescale on which the fiscal empowerment of Holyrood takes place, the Act leaves the *exact point of transition* to the determination of HM Treasury: disapplication "has effect in relation to ["land transactions with an effective date" / "disposals made"] on or after such date as is appointed by the Treasury by order".[81] The absence of a 'handover date' specifically fixed in the legislation which businesses and legal bodies could 'prepare towards' has been mitigated in practice by general agreement to 'work towards' April 2015 as the cut-off point, but is nonetheless ultimately indicative of the complicated and unusual constitutional relationship in which Scotland and the UK currently stand.[82]

3.10. For the Scotland Act to come into effect, legislation equivalent to the relevant provisions in it must also be passed by the Scottish Parliament: since the allocation of legislative scrutiny time is wholly the Scottish Parliament's responsibility, HM Treasury must, in effect, wait on the Scottish institutions to complete their part of the transfer process before the date can be appointed.

3.11. At the risk of permitting a degree of uncertainty for those affected by the transfer, the Act thus has a degree of institutional flexibility built into its implementation mechanisms, to reflect the active role both tiers of governance must play in the actual process of 'making devolution happen'. In more general terms, this suggests that transfers of powers from Westminster to Holyrood are—and must be—a matter for *cooperation* and *concerted action* between the Scottish and UK Governments, in order to avoid the unnecessary confusion of inter-institutional disagreement for individuals and businesses affected by the transfers. **The APPTG takes this as evidence that both governments have a *duty of guidance* towards individuals, businesses, and communities in Scotland and the RUK—a duty which cannot be abrogated, or offloaded by either tier onto the other.**

3.12. The Calman Commission's recommendations for additional borrowing powers for Scotland were translated into the Scotland Act as a power for the Scottish Ministers to borrow for four purposes: (1) to "manage excessive in-year volatility of receipts [into the Scottish Consolidated Fund], where actual income differs greatly from the forecast receipts for that month"; (2) to "provide [...] enough balance [to the SCF] to ensure cash-flow"; (3) to "meet the differences between forecast and outturn receipts for devolved taxes or from income tax charged by virtue of a Scottish rate resolution"; and (4) to "fund capital expenditure".[83]

3.13. Borrowing to manage volatility, ensure cashflow, and meet differences can only be from the Secretary of State for Scotland, but borrowing for capital expenditure can come from other sources instead, or as well.[84] As phrased in the Act:

> **32 Borrowing by the Scottish Ministers**
>
> (1) The 1998 Act is amended as follows.
>
> (2) Section 66 (borrowing by the Scottish Ministers etc) is amended as follows.
>
> (3) For subsection (1) substitute—
>
> "(1) The Scottish Ministers may borrow from the Secretary of State—
>
> (a) any sums required by them for the purpose of meeting a temporary excess of sums paid out of the Scottish Consolidated Fund over sums paid into that Fund,
>
> (b) any sums required by them for the purpose of providing a working balance in the Scottish Consolidated Fund, and
>
> (c) any sums which in accordance with rules determined by the Treasury are required by them to meet current expenditure because of a shortfall in receipts from devolved taxes, or from income tax charged by virtue of a Scottish rate resolution, against forecast receipts.
>
> (1A) The Scottish Ministers may, with the approval of the Treasury, borrow by way of loan any sums required by them for the purpose of meeting capital expenditure.
>
> (1B) A sum is required for the purpose of meeting capital expenditure if the expenditure would be capital expenditure for the purposes of accounts under section 70."

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[81] Scotland Act 2012 c. 11 Sections 29(4), 31(4).
[82] Scottish Government, *First Annual Report on the Implementation and Operation of Part 3 (Financial Provisions) of the Scotland Act 2012* (2013), p.5.
[83] HM Government, *Scotland Act 2012 Explanatory Notes* (2012), §172.
[84] Ibid., §174.

[...]

(5) After subsection (4) insert—

"(5) The Secretary of State may by order made with the consent of the Treasury amend subsection (1A) so as to vary the means by which the Scottish Ministers may borrow money."

[...]

(9) After subsection (3) insert—

"(3A) An amount substituted under subsection (3) may be more or less than the amount for which it is substituted but may not be less than £500 million."

(10) After section 67 insert—

"**67A Lending for capital expenditure**

(1) The aggregate at any time outstanding in respect of the principal of sums borrowed under section 66(1A) shall not exceed £2.2 billion.

(2) The Secretary of State may by order made with the consent of the Treasury substitute for the amount (or substituted amount) specified in subsection (1) such amount as may be specified in the order.

(3) An amount substituted under subsection (2) may be more or less than the amount for which it is substituted but may not be less than £2.2 billion.

[...]"[85]

In other words, Scotland is now "able to run up to £2.7bn of outstanding debt, of which up to £500m of debt can be from current borrowing and £2.2bn of debt from capital borrowing"—i.e., up to 10% of the Scottish Government's annual capital budget.[86]

3.14. The imposition of the limit on borrowing stemmed from the Calman Commission's recommendation of Scottish borrowing "on a Prudential basis", i.e., where "the Treasury has the ability to set conditions and a cap on the amount of borrowing, for macro-economic reasons, and where the amount Scottish Minsters might borrow in any one year should be constrained by their overall indebtedness and their capacity to repay from tax and other receipts".[87] The specific value of £2.7bn was designed to meet the Commission's suggestion of a limit "which enables the Scottish Parliament to increase its capital budget in any one year—currently something over £3bn—by a reasonable proportion".[88]

3.15. Finally, the 2012 Act refined and clarified the mechanisms by which further *fiscal* empowerment of the Scottish Government could take place, supplementing the mechanisms for further *political* empowerment under Section 30 of the 1998 Act. The following provision was added to the 1998 Act:

80B Power to add new devolved taxes

(1) Her Majesty may by Order in Council amend this Part so as to—

(a) specify, as an additional devolved tax, a tax of any description, or

(b) make any other modifications of the provisions relating to devolved taxes which She considers necessary or expedient.

(2) An Order in Council under this section may also make such modifications of—

(a) any enactment or prerogative instrument (including any enactment comprised in or made under this Act), or

(b) any other instrument or document,

as Her Majesty considers necessary or expedient in connection with other provision made by the Order.

3.16. A comparison with the slightly vaguer, more general wording of Section 30(3) (see §2.3 above), is instructive here. Section 30(3) makes provision for "specify[ing] functions which are to be treated [...] as being, or as not being, functions which are exercisable in or as regards Scotland", which leaves room *not only* for additional

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[85] Scotland Act 2012 c. 11 Section 32.
[86] HM Government, *Scotland Act 2012 Explanatory Notes* (2012), §173.
[87] Commission on Scottish Devolution, *Serving Scotland Better*, p.109.
[88] Ibid., p.109.

devolution of so-far reserved matters from Westminster to Holyrood, *but also* for moves in the opposite direction, i.e., the returning of devolved powers to Westminster authority. By contrast, the provision for new taxes in Section 80B(1)(a) only mentions the specification of "additional devolved tax[es]": the implied constitutional choice is no longer between *devolution* and *recentralisation*, but between *further devolution* and *maintenance of the status quo*.

3.17. This reflects a changed logic in relations between London and the devolved regions (specifically, Scotland) between 1998 and 2012, in light of the confidence of the Calman Commission (and its equivalents for Wales and Northern Ireland) in the success of devolution up to now. **The prevailing attitude in centre-periphery relations is now that *if any change is to occur at all*, it will always involve a trend towards greater autonomy. Though the legal mechanisms are still in place if needed, the likelihood of transferred powers being revoked is much lower now than it was when the first wave of devolution legislation was passed. The APPTG believes that this has major implications for the various trajectories a post-referendum Scotland could take.**

3.18. In parallel to the mechanisms for greater fiscal empowerment, the 2012 Act created the scope for greater autonomy in the administrative arrangements for tax collection within Scotland—in other words, the functions fulfilled up to now by HM Revenue & Customs and its immediate predecessors. Section 93 (agency arrangements) of the 1998 Act reads as follows:

> **93 Agency arrangements**
>
> (1) A Minister of the Crown may make arrangements for any of his specified functions to be exercised on his behalf by the Scottish Ministers; and the Scottish Ministers may make arrangements for any of their specified functions to be exercised on their behalf by a Minister of the Crown.
>
> (2) An arrangement under this section does not affect a person's responsibility for the exercise of his functions.[89]

3.19. The 2012 Act inserted a provision into this section explicitly and irreducibly dividing the responsibilities of Scottish and UK ministers over fiscal policy in Scotland:

> (2A) The collection and management of a devolved tax is a specified function of the Scottish Ministers.[90]

This is reinforced by the addition of "Devolved taxes, including their collection and management" to the "Exceptions" in Schedule 5 of the 1998 Act, Section A1 (specific reservations: fiscal, economic and monetary policy).[91] Further, Section 113 of the 1998 Act (Subordinate legislation: scope of powers) gives Scottish Ministers the ability to use any means they deem necessary to effect the exercise of newly devolved powers:

> **113 Subordinate legislation: scope of powers.**
>
> [...]
>
> (2) A power may be exercised so as to make different provision for different purposes.
>
> [...]
>
> (4) A power includes power to make—
>
> (a) any supplementary, incidental or consequential provision, and
>
> (b) any transitory, transitional or saving provision,
>
> which the person making the legislation considers necessary or expedient.
>
> [...]
>
> (7) A power may be exercised so as to make provision for the delegation of functions.[92]

3.20. So far, the main application of this power has been the planned creation of Revenue Scotland via primary legislation as the "tax authority responsible for the administration of Scotland's devolved taxes", focusing initially on the administration of LBTT and the Scottish Landfill Tax.[93] The Consultation on Tax Management also proposed that "Revenue Scotland should be able to delegate some of its powers to other

[89] Scotland Act 1998 c. 46 Section 93.
[90] Scotland Act 2012 c. 11 Section 23(3).
[91] Ibid., Section 23(5).
[92] Scotland Act 1998 c. 46 Section 113.
[93] Scottish Government, 'Revenue Scotland', 7 February 2013.

bodies", specifically by continuing the current practice of outsourcing administration and regulation to *existing* external institutions. This includes "giv[ing] Registers of Scotland (RoS) responsibility for collecting LBTT, and the Scottish Environment Protection Agency (SEPA) responsibility for collecting the Scottish Landfill Tax".[94]

3.21. The Scottish rate of income tax, meanwhile, is *not* being treated administratively as a devolved tax, and is thus not, for now, the responsibility of Revenue Scotland. In the words of Eleanor Emberson, Head of Revenue Scotland:

> SRIT will be administered by HMRC, as any other arrangement would require taxpayers—or employers, through PAYE—to manage returns and payments to two separate tax authorities for one tax. The revenue raised through SRIT will be paid into the Scottish Consolidated Fund.[95]

Though the fundamental institutional frameworks for Scotland to collect tax geographically attributable to Scotland are now in place, it is still administratively most convenient for HMRC to retain full control of administering income tax, and all other non-devolved fiscal activity.

The implementation of the Scotland Act 2012 and its implications

3.22. The statutory implementation of these new powers by the Scottish Government is taking the form of three items of legislation so far: (1) the Land and Buildings Transaction Tax (Scotland) Act 2013; (2) the Landfill Tax (Scotland) Bill; and (3) the Revenue Scotland and Tax Powers (Scotland) Bill. The timetable for the progress of the three Bills is as follows:

Table 3.1: Timetable for the enactment of Scottish Government legislation for the newly devolved taxes and administration arrangements[96]

Subject of legislation	Consultation	Introduction	Enactment
Land and Buildings Transaction Tax[97]	07.06.2012 – 30.08.2012	29.11.2012	25.06.2013
Landfill Tax[98]	25.10.2012 – 15.01.2013	17.04.2013	12.2013
Revenue Scotland and Tax Powers[99]	10.12.2012 – 12.04.2013	11.2013	06.2014

3.23. Some stakeholders have raised concerns at the limited Parliamentary time that has been scheduled for each Bill, due to political pressure to pass the legislation required for full control over the newly devolved taxes before the referendum takes place. The suggested reason is that the Scottish Government are hoping to be able to provide approximately a year's worth of concrete proof to their electorate that Scotland can effectively manage its own fiscal affairs before the referendum takes place.

3.24. This also explains why the two *substantive* tax Bills have been scheduled to come out *before* the Bill which sets out the structure and guiding principles of the Scottish tax regime, and which thus legislates for the two previous Bills' implementation and administration. Moving the Tax Management Bill to *before* the LBTT and Landfill Tax Bills would both delay the moment when Scotland would become formally in charge of its new

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[94] Scottish Government, *A Consultation on Tax Management* (2012), p.69.
[95] Eleanor Emberson (Head of Revenue Scotland), *Email*, 1 March 2013; HM Government, *Strengthening Scotland's Future* (2010), p.26.
[96] For the approximate predicted points in the timetable, I am grateful to Fergus Cochrane and Alan Hunter (Clerks, Scottish Government Finance Committee). *Interview*, 13 November 2012. See also Scottish Government, *Consultation on Tax Management*, p.11.
[97] Scottish Government, 'Taking forward a Scottish Land and Buildings Transaction Tax'; Scottish Parliament, Land and Buildings Transaction Tax (Scotland) Bill.
[98] Scottish Government, 'Protecting our Resources—Consultation on a Scottish Landfill Tax'.
[99] Scottish Government, 'A Consultation on Tax Management'.

fiscal responsibilities, and (further) curtail the time in which Revenue Scotland would need to become fully operational (which the present timetable has set at summer 2014).

3.25. It has also been suggested that the Scottish Parliament is working very much 'at capacity' to bring these three Bills into effect in the allotted timeframe. The overlap of the consultation periods and legislative stages for the three Bills has exhausted the scrutiny time of the relevant Scottish Parliament Committees (in particular the Finance Committee), which means that it would be impossible to effect any *further* devolution of powers before the referendum. **The APPTG takes this as an indication that if further powers are devolved after the referendum, the Scottish Parliament should consider bringing in expert support, at least temporarily, to help its Committees cope with the continued high workload this would entail**.

3.26. The Scottish Government's approach has certain advantages. Prioritising the development of the LBTT and Landfill Tax Bills, and agreeing on a tax framework, gives some measure of certainty to business, and leaves the administrative aspects of the Tax Management Bill to be settled while Scottish businesses are adjusting to the new system. Further, the consultations for the Tax Management Bill will benefit from the practical example of the LBTT and Landfill Tax frameworks, rather than relying on developing it in abstract. **The APPTG notes that the Scottish approach to evolving its new taxes has been careful and rigorous, relying on 'sounding out' all the potential issues associated with them and incorporating experience from policy implementation. The APPTG believes that this will make for more robust future fiscal policy, both for these taxes and for any others devolved in future.**

3.27. However, it is worth observing that it also means that the two most significant parts of the newly-devolved fiscal powers—borrowing and the Scottish rate of income tax—will not be in effect by the time the referendum takes place. The new borrowing powers will only come into effect in April 2015, with a very "limited version of the power in place" from April 2013 to fund £100m of pre-payments for the Forth Road Crossing, which means that one of the best indicators of the Scottish Government's financial responsibility—exercising fiscal restraint and careful budgeting—will be effectively unavailable to Scottish voters when they make their choice.[100] Similarly, under present plans for gradual transition, the effects of the Scottish rate of income tax will only begin to be felt from the start of the tax year in April 2016, after being set in the final budget of the current session of the Scottish Parliament in September 2015.

3.28. In this light, it is expected that the Scottish Government will communicate whether, and how, it intends to apply the SRIT to HM Government by December 2015, which means that voters will be unaware of whether, and how, the rate will initially be used when the referendum takes place in September 2014.[101] In fact, given that the Scottish Government is planning for a 17-month timetable for negotiations with the EU and UK Government between the referendum and the date of formal independence, it is likely that these devolutionary provisions would still be coming into effect (if things continue as planned) while Scotland would already be needing to prepare for the far more radical step of becoming fully independent.[102]

3.29. The APPTG can fully understand—and is, to a certain extent, sympathetic to—the motivations behind the speed of the ongoing legislative processes, insofar as the 1-year-long experience of greater financial autonomy will help those casting a vote in the referendum make a more informed decision about independence. **However, the concerns raised about the legislative timetable for the powers devolved so far prompts the APPTG to stress that any further increases in Scotland's fiscal autonomy must not be rushed through, but rather implemented carefully and thoroughly, and with due concern for the capacity of those affected by those increases to adjust to them.**

3.30. This is explicitly not a statement against greater empowerment, but merely an observation that, for Scotland to 'work' as either a region of the UK or an independent country, powers must be transferred in a way that makes institutional sense, minimises legal and practical unclarity, and allows individuals, communities, and businesses the space and time to accommodate each new stage of the changing constitutional relationship.

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[100] HM Government, 'Scotland Bill receives Royal Assent', 1 May 2012; Richard Teather (Associate Senior Lecturer, Tax Law, Bournemouth University), *Interview*, 9 October 2012.
[101] HM Government, *Strengthening Scotland's Future* (2010), p.26.
[102] Brian Taylor, 'Two sides shake on bill deal', *BBC News*, 22 March 2012.

Neither Scotland nor the RUK can afford to go directly against the related recommendation of the Calman Commission:

> RECOMMENDATION 3.6: These changes should be introduced in a phased way, step by step, to manage the risks of instability in public finances and of windfall gains or adverse shocks to the Scottish Budget.[103]

The APPTG takes the view that this recommendation should be taken extremely seriously for any future tranches of fiscal devolution, and suggests that it is only by virtue of the relatively small financial impact of the specific taxes that have been devolved in *this* stage that "instability in public finances" is likely to be avoided.

3.31. But at the same time, even with this high-paced legislative timetable, there is also a very real sense in which the process of implementing the 2012 Act has, in the words of the Scottish Government's former Minister for Strategy, Bruce Crawford MSP, "been bypassed by history and events".[104] As observed above, the referendum is taking place before many of the Act's more significant provisions are even starting to come into effect, which means that neither the two 'camps' in the referendum debate, nor the voters they are meant to inform and persuade, are in any position to know accurately how a post-Calman Scotland is going to work.[105] This is complicated by the fact that, on fiscal powers at least, the 2012 Act was decidedly "limited" in terms of the percentage of Scottish revenue it placed under direct Holyrood control.[106]

3.32. It is technically true to say, as the Prime Minister did at the time of the Bill's passage, that the Act constituted the "biggest act of fiscal devolution in Scotland's history".[107] **However, the APPTG believes that the primary virtue and significance of the Act is as an endorsement of the (success of the) general principle of greater empowerment of Scotland.** There is considerable scope for greater transfer of fiscal powers from Westminster to Holyrood: specifically, there remains a sizeable gap between the powers Scotland will have after the full implementation of the 2012 Act, and those it would have as a fully independent country. This is a gap which would have to be bridged in the event of a 'yes' vote to independence, and there is a clear limit to the extent to which the 2012 Act could be used as a 'stepping-stone' on the way to doing so.

3.33. What the Act has achieved, as the culmination of the work done on Scottish devolution since the 1980s (as outlined in this chapter so far), is confirm the special status and significance of fiscal policy within wider discussions around Scottish autonomy. In the legislation so far, financial matters have received separate and considerably more intense focus than all other branches of governmental activity. Two of the six parts of the 1998 Act (three out of seven after the 2012 amendment), and one out of four parts and three out of four schedules in the 2012 Act expressly dealt with financial matters.

3.34. The 2012 Act added "Devolved taxes, including their collection and management" to the "Exceptions" under Schedule 5, Part 2, Section A1 (specific reservations: fiscal, economic and monetary policy), of the 1998 Act—by far the most comprehensive and significant of a relatively small number of exceptions to the matters specifically reserved to Westminster authority. The overall effect is thus of a gradual erosion of the "reserved" status of fiscal policy—though not (yet) to the extent of challenging Westminster's economic primacy.

3.35. The 2012 Act has thus also laid the framework for questions to be asked about the other political aspects of the separation of the Scottish and UK polities. As observed by Sir Menzies Campbell MP, who chaired the Liberal Democrat party's initial policy consultation over Scotland's constitutional future, fiscal federalism and political federalism are necessarily closely connected.[108]

3.36. Yet at the moment, fiscal policy is, in some respects, *ahead* of developments with the 'top tier' of public policy concerns with regard to the separation of Scottish from UK institutions. The Scotland Act 2012 has

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[103] Commission on Scottish Devolution, *Serving Scotland Better*, p.112; Institute of Chartered Accountants of Scotland, *Scotland's Tax Future: What Tax System Would Scotland Want?* (2012), p.3.
[104] 'MSPs endorse new Holyrood powers under Scotland Bill', *BBC News*, 18 April 2012.
[105] Corin Taylor (Senior Economic Advisor, Institute of Directors), *Interview*, 19 October 2012.
[106] 'Scotland Bill becomes Scotland Act (2012) after Royal Assent', *BBC News*, 1 May 2012.
[107] 'MPs approve new Holyrood powers under Scotland Bill', *BBC News*, 26 April 2012.
[108] Sir Menzies Campbell MP, *Interview*, 1 November 2012.

introduced clear mechanisms for separate sovereignty over financial matters, while the "reserved matters" dividing line for other branches of government policy is a much cruder mechanism of separating Westminster and Holyrood responsibilities. Even without moves towards further autonomy or independence, this creates the potential for conflicts of authority in cases where elements of public policy still reserved to the UK Government have significant fiscal implications—especially in the cases of defence, social security, and transport policy.

3.37. But at the same time, the 2012 Act has established the initial frameworks for Scotland to start 'going its own way' in the areas beyond fiscal policy. This is due to the assumed contradistinction between the different regions of the UK implicit in creating an institution to deal separately with Scottish tax matters and taxpayers, as this introduces a dissimilarity in *treatment* between Scots and non-Scots which has the potential to grow into fully-fledged independent citizenships and national affiliations.

3.38. With the ongoing creation of Revenue Scotland, the infrastructure is now in place to administer future tranches of devolved taxes. Further, a model and precedent has now been established for how the 'Scottish parts' of other existing UK institutions could be hived off or replicated in case of institutional federalisation or full independence—such as the distinct Scottish capacity for reviewing economic and fiscal forecasts and policies proposed by John Swinney MSP in May 2013.[109] In other words, the work being done on fiscal policy at the moment will inform the implementation procedures for public policy across the board with future moves to greater Scottish autonomy.

Conclusion

3.39. The developments in Scottish devolution in recent decades have shown that institutional movement towards recognising the 'difference' between Scotland and the RUK is already well under way. What has become equally clear is that, as far as empowering Scotland is concerned, 'the only way is forward'. There is no significant appetite to reverse the trend of transferring powers from London to Edinburgh—and in light of the heightened tensions over full independence, even the suggestion of such a retrograde step would now be politically unthinkable. The primary question from now on thus becomes: *whether*—and secondarily, if so, *when* and *how*—to give Scotland *more* powers, especially fiscal powers.

3.40. **Given that the debate over greater autonomy for Scotland has, for now, been wholly subsumed into the debate over Scottish independence, the APPTG regrets the absence of an explicit consideration of *full independence* as a plausible option from assessments of Scotland's constitutional position up to now. The APPTG believes that, at least until September 2014, it should be the task of researchers and policy-makers to provide much-needed exploratory analysis that *does* take independence seriously as a possibility, and which provides the same degree of rigour as past assessments.** In other words, they need to take on the effective functions of a hypothetical 'Calman Commission 2.0' on an *ad hoc* basis, since there is insufficient time left before the independence vote for a formal commission to be established. This report, and the rest of the series, represents the APPTG's contribution to this analysis.

[109] Scottish Parliament Finance Committee, *Official Report* (2013).

4. Future scenarios for Scottish autonomy

4.1. The failure of previous assessments of Scotland's capacity to sustain greater autonomy to consider full independence, combined with the motivations for moving beyond these assessments' ultimate recommendations for Scotland, has produced considerable public uncertainty regarding what a 'Yes' or a 'No' outcome in the referendum *means*. Both governments, and both sides of the campaign, are waiting on each other to provide their 'vision' for Scotland—and the longer this waiting continues, the more public doubt and confusion over *what exactly is being voted on* will grow. Chapters 4 to 8 thus aim to shine some light on what is substantively at stake in the decision of whether Scotland should receive *full*, rather than *partial*, autonomy from the RUK. *Four* possible scenarios are examined—*outright* results for 'Yes' and 'No', and also *narrow* results for both options—and conclusions drawn about the prospects for Scotland's constitutional progression between the *status quo* and full independence.

The presumption of further autonomy

4.2. The main presumption made in this chapter is that, as suggested by the analysis in Chapters 1 to 3, the choice between 'Yes' and 'No' in the referendum corresponds broadly to the choice between Scotland being granted *complete*, or at least *much more*, autonomy versus *no more*, or at least *not much more*, autonomy. What is *not* being considered, or offered by any party or side in the campaign, is the option of *less*, or *no*, autonomy for Scotland. Such an option has become politically unimaginable, not least because of the current intensity of the modern 'Home Rule' debate.

4.3. Also, the wider trend in the UK is towards *more*, not *less*, local and regional autonomy and diversity—although, as observed by Geoff Mawdsley and Alison Payne of Reform Scotland, the UK is still very much "out of step" with the decentralising trend across Europe.[110] Wales and Northern Ireland are concurrently exploring the possibilities for more devolution, and the Department for Communities and Local Government is heavily engaged in empowering urban regions within England via City Deals and urban communities via Community Budgets.[111]

4.4. At the same time, the McKay Commission on the Consequences of Devolution has sought to find ways of aligning legislative procedures in the UK Parliament with the decreasing competence of the UK tier to legislate for regions outside England, and the House of Commons Political and Constitutional Reform Committee has recommended additionally exploring the scope for devolving powers to communities and local authorities within England.[112]

4.5. The trend of public opinion within Scotland is also away from centralised UK governance, even if this does not translate automatically into support for full *independence*. This point is borne out by the analysis of the most recent Scottish Social Attitudes Survey, where 50% of the people surveyed thought that "Scotland should remain part of the UK, with its own elected parliament which has *some* taxation powers", as against 24% who favoured full independence, and 11% who preferred devolution *without* taxation powers for Scotland.[113]

4.6. Elaborating the extent of these powers, the Survey found consistently high support for the Scottish Parliament "mak[ing] most of the important decisions for Scotland" about welfare levels (64%) and tax levels (56%), as compared to significantly lower equivalent support for decisions about defence policy and foreign

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[110] Geoff Mawdsley and Alison Payne (Director, and Research Director, Reform Scotland), *Interview*, 13 November 2012.

[111] Mike Sergeant, 'Six biggest English cities get extra powers', *BBC News*, 5 July 2012.

[112] McKay Commission, *Report of the Commission on the Consequences of Devolution for the House of Commons* (2013), pp.7-10; House of Commons Political and Constitutional Reform Committee, *Do we need a constitutional convention for the UK?* (2013), pp.3-4; 'England-only laws "need majority from English MPs"', *BBC News*, 25 March 2013; 'MPs demand answer to "English question"', *BBC News*, 5 April 2013.

[113] Scottish Centre for Social Research, 'Further Tables on Attitudes towards Scotland's Constitutional Future', *Scottish Social Attitudes 2012* (2013), p.1.

affairs (34%).[114] These levels are similar to support for devolved Scottish control of the health service and education, at 66% and 63% respectively, for which Holyrood already has exclusive responsibility.[115]

4.7. In more concrete terms, a system of 'devo max' giving the Scottish Parliament exclusive responsibility for fiscal policy was supported by 32% of survey respondents, leading the Survey's directors to conclude that, while "certainly not the first preference of a majority of people in Scotland, and may[be] not even […] the single most popular option", "[r]emaining within the Union but giving the Scottish Parliament responsibility for everything apart from defence and foreign affairs appears capable of securing the consent of a majority of people in Scotland".[116]

4.8. In fact, since 1999, the Scottish Social Attitudes Survey has shown a consistent lead for the option of Scotland having 'devolution' (with or without extensive tax powers) over independence of between 9% and 38%, with the option of no devolution (i.e., fewer powers) a distant third (see figure 4.1).[117] Indeed, before the Edinburgh Agreement definitively ruled out the possibility of a 'three-option' referendum, the somewhat sparse polling that had been carried out *with* a stated option for 'devo max' indicated a plurality of support for a 'middle-way' alternative, usually characterised vaguely as 'more powers but not independence' (see figure 4.2).[118]

Fig. 4.1: Scottish Social Attitudes Survey — Constitutional Preference

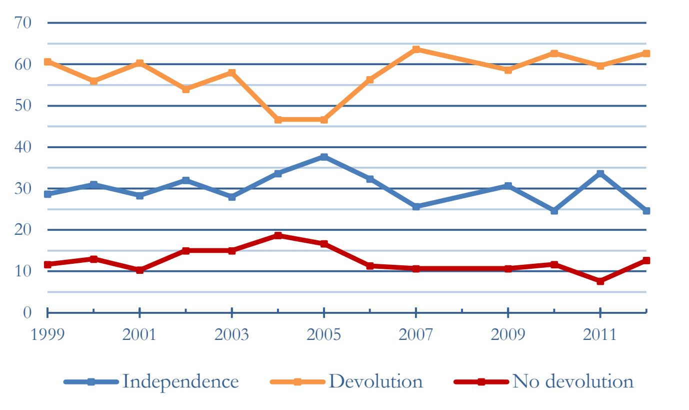
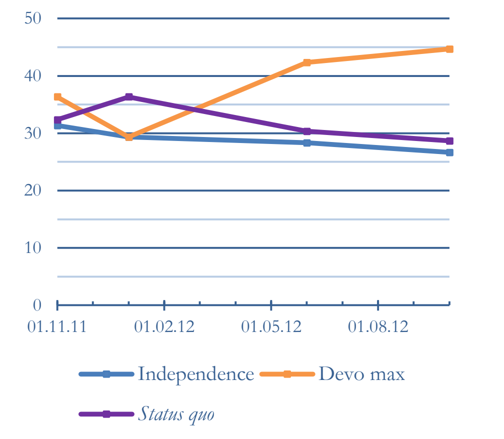


Fig. 4.2: Three option polling



4.9. The implication is thus that, even in the case of a 'No' vote to *Scottish independence*, the question of *greater Scottish autonomy* is not going to disappear from the agenda. The main Unionist parties in Scotland have recognised this, and are developing counter-proposals to the SNP 'offer' of independence as the build-up to the referendum progresses.

4.10. The Scottish Liberal Democrats' Home Rule and Community Rule Commission explicitly endorsed a federal alternative settlement in their October 2012 report *Federalism: the best future for Scotland*. The initial contribution of Scottish Labour's Devolution Commission, *Powers for a purpose—strengthening devolution*, released in April 2013, points to an endorsement of a 'devo more' settlement that seeks to slightly extend the provisions of the Calman Commission's recommendations. Even the Scottish Conservatives, traditionally opposed to *any* cession of powers from Westminster to Holyrood, have suggested increasing openness in their party

[114] John Curtice and Rachel Ormston, 'Attitudes towards Scotland's Constitutional Future: Initial findings from Scottish Social Attitudes survey 2012' (2013), p.3.
[115] John Curtice and Rachel Ormston, 'Scottish independence: case for wider devolution', *Scotsman*, 19 March 2013.
[116] Curtice and Ormston, 'Attitudes towards Scotland's Constitutional Future', p.3.
[117] Scottish Centre for Social Research, 'Further Tables', p.2. Respondents answering 'Don't know' or equivalent responses are distributed equally among the other response options for ease of reference.
[118] 'Scottish Independence', *UK Polling Report*. Respondents answering 'Don't know' or equivalent responses are distributed equally among the other response options for ease of reference. See also Gavin McCrone, 'Shaping life after No vote', *Scotsman*, 31 July 2013.

platform to a federal solution for Scotland, in direct contradistinction to the more centralist language of the national party.[119]

4.11. Since even the most staunchly Unionist parties have accepted the case for more devolution, it is very likely that the end of the current 'round' in the Scottish autonomy debate will *at the very least* "go beyond the Scotland Act"—possibly via a further Scotland Act devolving further powers from Westminster to Holyrood.[120] Though there has been no *commitment* that this will be the case, what is of particular interest with this *eventuality* is that the powers to be devolved will be predominantly *fiscal*, since welfare benefits and taxation are the two areas of Scottish domestic policy over which Westminster retains primary control. **The APPTG thus observes that even a strong 'No' vote in September 2014 may still ultimately result in a settlement which gives Scottish governmental institutions significantly greater fiscal responsibility—and possibly not in the way either the 'Yes Scotland' or the 'Better Together' campaigns anticipate.**

The importance of post-referendum analysis

4.12. The referendum itself is only part of the process of determining a new settlement for Scotland relative to the UK. Whatever the outcome, the referendum *informs*, *but does not itself take*, the decision to become, or not become, independent—it is a mechanism for *ratifying the principle* of Scottish independence or non-independence, but *not for making this effective* as Scotland's constitutional status.[121] As observed by several evidence-givers to the House of Lords Economic Affairs Committee's recent inquiry into the economic impact of Scottish independence, the details of any settlement will need to be agreed by the Scottish and UK authorities based on the 'guidance' offered by the referendum result—even in the case of a 'No' vote.[122]

4.13. **The APPTG does not support the idea of a two-stage process, specifically the need for a *second* referendum to ratify the outcome of inter-governmental negotiations, as mooted in the evidence to the House of Lords Economic Affairs Committee enquiry**.[123] But it is important to emphasise that the *generality* of the 2014 referendum question leaves much to be determined by these negotiations. Even within a broad 'Yes' or 'No' framework, there is still a lot of room for variation and manoeuvre—a large number of outcomes that could technically eventuate.

4.14. Negotiations will be needed to determine how the referendum result should be *interpreted*—specifically, for the Scottish and UK Governments to reach a compromise or consensus position on its interpretation that is *unanimous*, *plausible*, and *legitimate*. Also, the *implementation* of the settlement that results from these negotiations will require co-ordinated legislation by both the Scottish and UK Parliaments afterwards, drawing out the autonomy *process* even further.

4.15. Though the role of negotiations is not widely appreciated, they contribute significantly to the inability of the practical meaning of 'independence'—and, by extension, 'non-independence'—to be known before substantive engagement takes place between the Scottish and UK Governments, and their proxies in the 'Yes' and 'No' campaigns. Yet for the vote in September 2014 to be at all meaningful, the latent ambiguities around both terms need to be dispelled as far as possible in advance of the referendum—and hence, given the UK Government's position, in advance of such negotiations taking place.

4.16. This point has been illustrated most clearly by the Electoral Commission's advice document on the referendum question, the research for which found significant variation in public understandings of the term "independent".[124] These included constitutional interpretations such as "separate from the rest of the UK",

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[119] 'Tories back more powers for Scottish Parliament', *Scotsman*, 25 January 2013; 'Scottish Tories distance themselves from UK party', *Telegraph*, 25 January 2013; Curtice and Ormston, 'Scottish independence: case for wider devolution'.
[120] Mawdsley and Payne, *Interview*.
[121] Karen Henderson (Senior Lecturer, University of Leicester), *Interview*, 24 October 2012.
[122] House of Lords Economic Affairs Committee, *Economic Implications*, Oral Evidence—Prof David Bell (15 May 2012), QQ 5, 10-11, 27; Prof John Kay (22 May 2012), QQ 84-5, 93, 96; Prof Gavin McCrone (29 May 2012), QQ 123-4, 128-9, 137, 142, 166; Prof Robert Rowthorn (12 June 2012), QQ 189, 191, 229, 240-1.
[123] Sinton, *Interview*.
[124] Electoral Commission, *Referendum on independence for Scotland*, pp.22-30.

"separate from England", "separate from England, Wales, and Northern Ireland", and "separate from Westminster", as well as more practical variants, including "running our own affairs" and "Scotland managing on its own".[125]

4.17. While these interpretations are all technically correct, they reveal prospective voters' different emphases and concerns about the "pros and cons of each outcome […] and what independence would mean in practice for Scotland", which can only be assuaged by the introduction of unbiased, objective information to the debate, as the Electoral Commission has recommended.[126] **Of the issues about which the Electoral Commission's consultations found greatest uncertainty—"the economy, currency, monarchy, defence, immigration and citizenship"—the APPTG considers those with major financial implications as being the most pressing in the current macroeconomic climate.**[127]

Four post-referendum scenarios

4.18. In practical terms, giving Scottish voters more exact definitions of 'independence' and 'non-independence' is a matter of considering the extent of de-reservation (and devolution) of the 'reserved matters' that remain under Westminster control. The more devolved the settlement for Scotland, the more mandatory separation there will have to be between Scottish and RUK institutions, and the fewer structures will remain joint or shared across the whole UK territory. The disagreement between the different sides in the autonomy debate is thus effectively between different views of which 'balance' of separation and sharing of political and economic institutions is 'right' for Scotland and the RUK.

4.19. **The APPTG's approach to the debate is to examine what each 'type' of devolution settlement, or each referendum outcome, would 'allow'—or even 'force'—Scotland to do separately from UK.** The next four chapters specifically address how a trajectory of 'ratcheting-up' autonomy develops from stage to stage, focusing explicitly on the effects of four possible 'types' of referendum outcome: *outright* 'No', *narrow* 'No', *narrow* 'Yes', and *outright* 'Yes'.[128] Each one is assessed in turn, in the order from least to greatest change, relative to the *status quo* after the full implementation of the Scotland Act 2012.

4.20. The terminology used to distinguish between each of the two 'No' and 'Yes' outcome 'types' is that of *concession* and *aspiration*.[129] For both 'No' and 'Yes', *concession* indicates a tendency to aim for an outcome that minimises the change in conditions needed to achieve the status for Scotland implied by the outcome voted for—in other words, as little change as possible for 'No', and a bare satisfaction of the technical requirements for independence in the case of 'Yes'. By contrast, for both 'No' and 'Yes', *aspiration* signifies a more daring, experimental attitude that is open to exploring the maximum extent of potential progress along the devolutionary trajectory, within the bounds set by the outcome voted for—in other words, as devolved a settlement as possible for 'No', and as radical a separation as possible for 'Yes'.

4.21. The terms as they are used here refer less to Scottish voters' degree of commitment to devolution, as inferred from the overall outcome in September 2014, than to the likely tenor of the post-referendum negotiations, which the referendum outcome mandates the negotiating sides to adopt.

4.22. This report thus takes a different approach to the constitutional questions of Scottish autonomy and independence, and their fiscal consequences, from past discussions and analyses. **Instead of offering specific recommendations for what Scotland *ought to look like*, the APPTG has chosen to examine the question from the angle of the possible outcomes of the referendum in September 2014—the various plausible options for what Scotland *could look like*. In doing so, the APPTG is not trying to *pre-empt* the visions to be formulated by the Scottish parties and referendum campaign groups.**

[125] Ibid., p.15.
[126] Ibid., p.16.
[127] Ibid., p.16.
[128] This approach ties in with recent developments in strategic analysis of the referendum. See Andy Maciver, 'Make your mind up time for the vote', *Scotsman*, 16 August 2013.
[129] The distinction between *concession* and *aspiration* is taken from the work of the moral philosopher David Estlund. See 'Utopophobia: Concession and Aspiration in Democratic Theory', chapter in David Estlund, *Democratic Authority* (Princeton, NJ: Princeton University Press, 2009), pp.258-76.

Rather, this report aims to put the visions for Scotland due to be articulated over the next year in some form of context of procedural necessity and political-economic feasibility.

4.23. **The APPTG emphasises that its remit in this report is to examine the implications of Scottish autonomy for fiscal policy in Scotland and the RUK.** Although wider economic concerns, especially monetary policy, will doubtless have significant fiscal implications, they are not the primary object of analysis here, and are addressed here only insofar as they bear on fiscal policy.[130]

4.24. **The APPTG also emphasises that the interpretations of the four referendum results offered below, especially of their strategic and party-political implications, are assessments of the *likely directions* in which the autonomy debate will develop in the case of each result. They are explicitly *not* recommendations for particular directions in which the debate *should* develop, nor do they endorse outcomes which the APPTG would prefer to see.** The APPTG's interpretations are based on the evidence of political and economic stakeholders, and a syncretic overview of previous analyses of Scotland's constitutional position relative to the UK.

[130] For an examination of the wider economic impact of Scottish independence for Scotland the UK as a whole, see House of Lords Economic Affairs Committee, *Economic Implications*. The APPTG takes this opportunity to thank the Committee Clerk, Bill Sinton, for his invaluable assistance in allowing the APPTG to build on the Committee's analysis for the explicit focus on fiscal policy in this report.

5. Scenario 1: Keeping the common society — an outright 'No' vote

5.1. The first scenario, an *outright* 'No' vote, is defined as a referendum result where fewer than 40% of Scottish voters vote 'Yes', and more than 60% vote 'No'—in technical terms, a *supermajority* for 'No'. The closest comparable situations are the referendum over the introduction of the Alternative Vote electoral system in May 2011, where 'No' defeated 'Yes' by 67.9% to 32.1%, or the referendum over the institution of a regional assembly in North-East England in November 2004, where 'No' defeated 'Yes' by 77.9% to 22.1%.[131]

Effects on the Scottish autonomy debate

5.2. The basic effect of a strong rejection of independence would be a serious weakening of the case for further empowerment of Scottish institutions. From a strategic perspective, the SNP-led Scottish Government would be in a much worse bargaining position than it has been since its overwhelming victory at the Scottish Parliament elections in May 2011, and the extensive mandate this gave it to pursue its conception of the autonomy agenda.[132]

5.3. In the debate over the devolution of the remaining powers reserved to Westminster, a clear victory for 'No' would be seen—or, at least, framed by Unionist parties—as a broad endorsement of the *status quo*. Any question of a significant shift in Scotland's constitutional status, let alone the topic of independence, would likely be taken off the agenda for the foreseeable future. Though the dynamics of negotiations will be extensively determined by the context in Westminster as well, in the build-up to the UK General Election in 2015, there is a clear possibility that, as argued by Professor John Kay, a 'No' vote may *not* lead to any more significant devolution.[133]

5.4. **Insofar as any consideration is given to such a 'better deal' after a heavy 'No' vote, the APPTG takes the view that it would be restricted to only 'tinkering at the edges' of the current state of the overarching regional settlement.** Short of a far-reaching, wholesale reassessment of regional policy in the UK, the only immediate priority that would be given to devolution to Scotland—or, for that matter, more widely in the UK—would concern possible *semi-isolated* changes designed to achieve parity of empowerment between the regions to whom competencies have already been devolved. The (few) powers that might be ceded beyond the implementation of the Scotland Act 2012 would thus be primarily intended to match up the settlement for Scotland with those agreed with Wales and Northern Ireland, in order to maintain the overall picture of the UK as a 'common society'.

5.5. **The APPTG notes that this is the method by which devolution has traditionally taken place in the UK.** The powers devolved from Westminster to subsidiary tiers of governance are determined by the stated needs and demands of each subsidiary, and the precise details of the devolution 'deal' by bipartisan negotiation between the subsidiary and central government. This produces a devolutionary system that is asymmetric and differential, with different 'deals' holding simultaneously between the UK tier and the different subsidiary tiers.

5.6. The only 'involvement' of other devolved regions in such 'deals' comes through rivalrous comparison between them and the negotiating subsidiary, or their citation as a precedent with proven success or workability. This is transparently seen in, for example, the fiscal recommendations of the Silk Commission on Devolution in Wales:

[131] 'Vote 2011: UK rejects alternative vote', *BBC News*, 7 May 2011; 'North East votes "no" to assembly', *BBC News*, 5 November 2004.
[132] Scottish National Party, *Manifesto 2011: Re-elect a Scottish Government working for Scotland* (2011), p.28.
[133] John Kay (Professor of Economics, St. John's College, University of Oxford), *Interview*, 6 November 2012.

> [W]e have recommended that business rates should be fully devolved to the Welsh Government in the same way as in Scotland and Northern Ireland, provided the UK Government and Welsh Government agree the appropriate adjustment to the Welsh block grant.[134]

5.7. **The APPTG also notes a degree of similarity between the UK's *asymmetric devolution* model and the principle of *variable geometry* at the European level, endorsed by the current Coalition government.**[135] Variable geometry describes a "method of differentiated integration which acknowledges that there are irreconcilable differences within the integration structure and therefore allows for a permanent separation between a group of Member States and a number of less developed integration units".[136]

5.8. The application of this principle in the EU is that individual member states decide which of the common European practices or arrangements they will 'sign up to', or participate in. The parallel within the UK is that, with each devolutionary 'deal', the UK regions decide which common (i.e., centralised) UK practices or arrangements they will 'exit from', or *stop* participating in. **The APPTG sees this as a useful way to understand the question of the relationship between devolution and the maintenance of the 'social Union' in the UK.**

Effects on Scotland's fiscal arrangements

5.9. The two likeliest changes that would be made to Scotland's devolved settlement in this post-referendum scenario would be the devolution of *air passenger duty* and *aggregates levy*. Both were part of the Calman Commission's recommendations, but were omitted from the Scotland Act 2012. Meanwhile, the Finance Act 2012 devolved the power to set APD rates on direct long-haul flights to the Northern Ireland Assembly, which subsequently legislated to effectively abolish them.[137]

5.10. The Silk Commission has also recommended the devolution of aggregates levy to the Welsh Government, as well as "long haul rates of Air Passenger Duty, and consideration of full devolution in the future".[138] The attainment of 'full Calman' as the next 'deal' for Scotland would thus be the very minimum acceptable result for Scotland after the referendum, as well as a classic example of the 'UK way of doing devolution'.

5.11. The other major tax which the Scottish Government has identified for devolution, over and above the campaign for independence, is *corporation tax*, which was the subject of a discussion paper in August 2011 designed to make the case for corporation tax's inclusion in the fiscal 'package' devolved in the 2012 Act. The Scottish Government's main economic rationale was framed in terms of competitiveness: encouraging investment by domestic firms in physical and human capital, boosting research and development, and making Scotland internationally attractive as a location for FDI.[139] As outlined earlier, however, the UK Government followed the analysis of the Calman Commission, which emphasised the volatility of corporation tax receipts, and the detrimental effects of tax competition within the UK, and rejected the Scottish Government's case (see §2.25).

5.12. The main reason for its consideration in this scenario is the ongoing parallel demand for corporation tax devolution from Northern Ireland, in order to compete with the low 12.5% rate in the Republic of Ireland. The economic case for this demand, which enjoys cross-party support at Stormont as well as strong business backing, is broadly similar to that made by the Scottish Government, but with an added urgency that derives from the extensive permeability of the Irish-Northern Irish border.

5.13. The Scottish Government made explicit reference to the prospect of the asymmetry of corporation tax devolution in its discussion paper:

> [T]he issue of ensuring a fair balance of competitiveness within the UK is even more important following the real possibility that corporation tax could be devolved to Northern Ireland … this would limit the

[134] Commission on Devolution in Wales, *Empowerment and Responsibility: Financial Powers to Strengthen Wales* (2012), p.6.
[135] 'William Hague: Britons' EU disillusionment deepest ever', *BBC News*, 23 October 2012.
[136] European Union, *Synthèses de la legislation* — Glossary, 'Variable geometry'.
[137] Finance Act 2012 c. 14 Section 190; 'Air passenger duty abolished on long haul flights', *BBC News*, 6 November 2012.
[138] Commission on Devolution in Wales, *Empowerment and Responsibility*, pp.5-6.
[139] Scottish Government, *Corporation Tax: Discussion Paper—Options for Reform* (2011), p.32.

> Scottish Government's ability to maintain the competitiveness of the business environment in Scotland and put Scotland at a significant disadvantage.[140]

Meanwhile, the Welsh Government have yet to follow up the Holtham Commission's recommendation of corporation tax devolution by demanding its inclusion in a new Government of Wales Act, but are closely observing developments in Scotland and Northern Ireland for similar economic reasons.[141]

5.14. **The APPTG does not believe that an outright 'No' vote would result in the inclusion of corporation tax in a future devolution 'deal' for Scotland.** The UK Government remains opposed to corporation tax devolution, as seen by the recent controversial postponement of the decision on whether to devolve corporation tax to the Northern Ireland Assembly until after the independence referendum.[142] Given the weak bargaining position of the Scottish Government, it is very unlikely that HM Treasury would allow itself to be pressured into relinquishing control of this significant part of business policy-formation. (See §6.31ff for analysis of corporation tax devolution.)

5.15. If any changes are made to corporation tax policy at all, the UK Government is likely to fall back on the asymmetric nature of the UK model of devolution: it might decide to devolve corporation tax to Northern Ireland based on the 'extenuating circumstance' of its proximity to the Republic of Ireland, but continue to reject any arguments of similarity between Northern Ireland and the other regions for the equivalent devolution to Scotland or Wales.

5.16. **The APPTG argues that corporation tax devolution would only be likely to take place under this scenario through a *concerted effort* from Scotland, Wales, and Northern Ireland (and possibly London as well) to persuade the UK governance tier to loosen its grip on regional business policy.**[143] The legal scope for more extensive fiscal devolution is certainly available, since its compatibility with EU state aid rules was confirmed by the ECJ judgment in the Azores case, and subsequent Basque and Gibraltar cases, under the conditions of subsidiary regions' *institutional autonomy*, *procedural autonomy*, and *financial responsibility*.[144]

5.17. Such an exertion of overwhelming pressure on central government is deeply unfamiliar within the UK system, given the comparatively recent introduction of devolution. Although such a 'bottom-up' process would be consistent with the demand-based approach to devolution adopted by the UK, there are no institutional precedents for any sort of 'Celtic cooperation' designed to leverage concessions from the UK Government—and few indications that inter-regional competition is likely to give way to strategic unity in the near future.[145]

Constitutional implications

5.18. **The only other way major devolutionary shifts would happen would be through a 'top-down' alternative, in the form of a "UK-wide solution" to the devolution question.**[146] There is increasing pressure for the macro-level effects of the different directions in which Scotland, Wales, and Northern Ireland on the rest of the UK, and the UK as a whole, to be analysed directly.[147] Part of the reason that the major Unionist parties have "indicated they want to look at the strength of the devolved governments in Scotland, Wales and Northern Ireland in the event of a No vote in the Scottish referendum" is that since 1997, radical constitutional chance has taken place in the UK "without thinking about it" in a unified way.[148]

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[140] Ibid., p.34.
[141] John Whiting (Chairman, Audit and Risk Committee, HM Revenue & Customs), *Interview*, 6 November 2012.
[142] Whiting, *Interview*, 13 August 2012; 'Corporation tax decision "deeply disappointing"', *BBC News*, 27 March 2013; 'Corporation tax decision after 2014', *Belfast Telegraph*, 26 March 2013.
[143] Eddie Barnes, 'Boris Johnson: "London should have Holyrood powers"', *Scotsman*, 16 May 2013.
[144] Portugal v Commission (C-88/03) [2006] ECR I-7115; [2006] 3 CMLR 45; Joined Cases C-428/06 to C-436/06; Cases T-211/04 and T-215/04.
[145] 'Scottish corporation tax demands spark tensions with Northern Ireland', *Guardian*, 31 May 2011.
[146] Mawdsley and Payne, *Interview*.
[147] Martin McCluskey (PA to Margaret Curran MP, Shadow Secretary of State for Scotland), *Interview*, 30 October 2012.
[148] McCluskey, *Interview*; 'Labour to back more Holyrood tax powers', *Scotsman*, 6 April 2013.

5.19. This is exactly what the establishment of a UK-wide Constitutional Convention, as recommended by the House of Commons Political and Constitutional Reform Committee, would be designed to mitigate.[149] **Although this would be a major shift in approach away from the familiar UK way of 'doing' devolution, or at least an uncharacteristic adaptation of the UK devolution model, the APPTG welcomes the move towards a thoroughgoing appreciation of 'how the UK fits together'.**

5.20. However, the APPTG is concerned that a heavy 'No' vote in the referendum may weaken the perceived rationale or justification of the need for any such radical shift in approach. A clear defeat for independence could militate against the devolutionary tendency in the UK, as it might be portrayed as not just an endorsement of the Union but also of the current level of empowerment of Westminster, and of the principle of *centralised* Parliamentary sovereignty.

5.21. The APPTG foresees a danger that a 'No' vote would have political spillover effects on regional devolution not just to Scotland, but throughout the rest of the UK. It might raise obstacles to the continuation of the devolutionary and localist programmes being pursued by the current Coalition Government *in general*, and to the attempts by the other devolved regions (Wales, Northern Ireland, London) to strengthen their empowerment 'deals' in future *in particular*. **The APPTG thus strongly suggests that the UK Government should formally commit to holding a 'National Conversation' about devolution, and instigating a nationwide approach to answering national, regional, and local constitutional questions immediately after the referendum in September 2014, regardless of the outcome.**

5.22. Even in the absence of a comprehensive reassessment of the constitution, there may also be alternative ways of maintaining the decentralising trend in the wake of an outright 'No' vote. One option might be a more informal attitudinal change at the UK Government tier to *openness to negotiation*—accepting the general case for greater devolution of powers *in principle*, but allowing the devolved subsidiary tiers to decide *when*, and *how far*, to 'cash in' this acceptance and push for institutional implementation *in practice*.

5.23. Under such an arrangement, the powers currently still reserved to Westminster become treated as *permanently open to auction*, with serious consideration given to the cases for further stages of devolution as and when they are put forward by the subsidiary tiers. **The APPTG believes that this would be most credibly achieved through the formal endorsement by the Westminster parties of the case for deepening regional autonomy, perhaps through the inclusion of explicit commitments to devolution in their party constitutions and election manifestos.** This approach is highly amenable to the way the UK has done things so far, with the main modification being the removal of the institutionalised opposition to regional autonomy at the UK level that has fuelled the "rancour" of the independence debate so far.[150]

5.24. **Another option might be to sidestep the question of devolution *from Westminster to Holyrood* entirely, and concentrate political focus at the Scottish and UK tiers on the possibility of devolving powers directly to the local government level.** This would help avoid the fear, which dates from the time of the Scotland Act 1998 and was recently realised by the merger of the 8 local Scottish police forces, that regional empowerment would come at the expense of the new government "sucking up" the powers of local authorities in lieu of receiving devolved powers from Westminster.[151]

5.25. One variant of localism, which could be particularly relevant in light of Scotland's heavy economic reliance on its four urban centres at Edinburgh, Glasgow, Aberdeen, and Dundee, is an implementation of a version of the UK Government's programme of City Deals, whereby individual urban regions negotiate "tailored" arrangements for the devolution of budgetary powers and urban policy from central government.[152] The APPTG will explore these, and other, possibilities in greater detail in a future report.

5.26. As well as these devolutionary shifts, there is likely to be strong parallel pressure for a replacement to be found for the Barnett formula as a way of calculating the block grant from Westminster to Scotland, Wales,

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[149] House of Commons Political and Constitutional Reform Committee, *Do we need a constitutional convention?*, pp.3-4; Simon Johnson, 'Sir Kenneth Calman calls for new powers commission if Scots reject independence', *Telegraph*, 20 September 2013.
[150] House of Lords Economic Affairs Committee, *Economic Implications*, p.8.
[151] Mawdsley and Payne, *Interview*; McCluskey, *Interview*; Jean McFadden, 'Holyrood's threat to local government', *The Journal of the Law Society of Scotland*, 1 July 1999.
[152] Marius Ostrowski, 'City Deals: First steps to English federalism?', *ResPublica*, 24 August 2012; Deputy Prime Minister, 'City Deals'.

and Northern Ireland. **The APPTG echoes the findings of the House of Lords Committee on the Barnett Formula in recommending that a shift is required towards a 'needs-based' formula, whereby a "dynamic" and "simple, clear, and comprehensible" system is used to allocate resources to the devolved regions "based on an explicit assessment of their relative needs", calculated "per head of population".**[153]

5.27. **The APPTG suggests that the pressure and incentives to effect such a shift are unlikely to be weakened even in the case of a very strong 'No' vote—especially since this pressure is likely to come most from the Welsh and Northern Irish devolved institutions. The APPTG also strongly suggests that the negotiations for such a recalculation must involve not just the UK, Scottish, Welsh, and Northern Irish tiers of governance, but also London and other English regions in some form, in order to avoid the persistent relative imbalances in public spending for which the Barnett formula has been criticised** (see §2.8).

5.28. **As part of these discussions, the APPTG can see significant scope for considering the introduction of alternatives to the block grant as a mechanism for funding devolved government, as considered by the Independent Expert Group for the Calman Commission.**[154] One such alternative would be *tax assignment*, whereby each subsidiary region is allocated a share of total tax revenues equivalent to the proportion raised in it, or attributable to it. Such an arrangement would retain central control and administration but increase link between regional tax and regional expenditure by giving Scottish institutions "a direct financial stake in the fortunes of the Scottish economy, and […] a stronger incentive to promote economic growth".[155]

5.29. The main obstacle to using assignment as a 'half-way house' between block grant and fiscal devolution is the difficulty of separately identifying Scottish (and other regional) tax revenues in an economy as heavily integrated as that of the UK. A temporary solution to this, while developing a lasting, sophisticated mechanism for calculating the assignment formula, would be to use a demographic or geographical share of the relevant tax revenues—though it is hard to see how this improves significantly on the problems of the Barnett formula. **This should be borne in mind when considering the tax assignment options explored in Scenario 2 below.**

5.30. The other alternative would be a medium-term revisiting of the possibility of greater *tax devolution*. **The APPTG believes that this is the likely long-term trend of devolution in the UK, especially for Scotland, as the limited immediate devolution that is likely under an outright 'No' outcome will do nothing to bridge the accountability and responsibility deficits between Scotland's high degree of control over public spending and comparatively limited authority over raising revenue.**

Conclusion

5.31. The APPTG refers to the substantive implications of this result as *concessive devolution*. In summary, the further devolutionary moves that can be expected for Scotland in this scenario are:

→ Devolution of *air passenger duty* and *aggregates levy* ('full Calman');

→ Devolution of *corporation tax* ONLY if pushed for collectively by devolved regions;

→ Further devolution only through a UK-wide Constitutional Convention and '*National Conversation*' about devolution;

→ Possible *direct empowerment of local government and urban centres* in lieu of regional devolution;

→ Shift from the Barnett Formula to a recalculated regional *needs-based resource allocation*;

→ Greater use of *tax assignment* as compromise between centralism and devolution.

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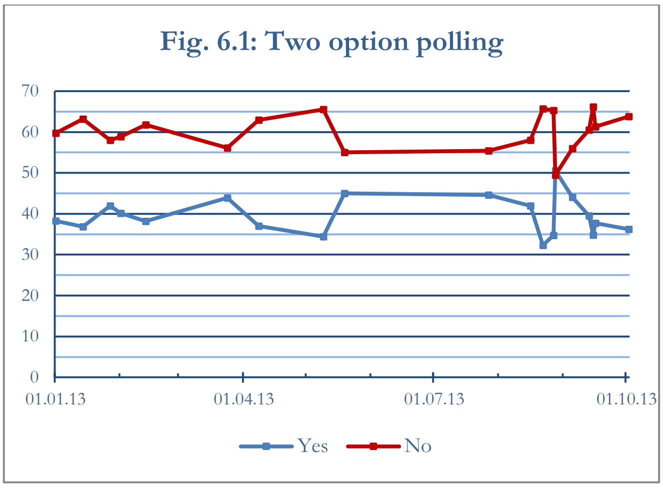
153 House of Lords Select Committee on the Barnett Formula, *The Barnett Formula* (2009), p.7.
154 Commission on Scottish Devolution, *Serving Scotland Better*, pp.77-9.
155 Ibid., p.78.

5.32. While an outright 'No' could thus be legitimately taken to indicate a broad endorsement of the *status quo for the time being*, it does nothing to diminish the tensions within the current arrangement which may eventually force the UK Government into recurring consideration of Scottish institutional empowerment. The permanence of the *status quo* is far from guaranteed, even if the Scottish electorate decides to endorse it in September 2014.

5.33. **Since the 'Scottish question' will not disappear, the APPTG believes that there is a possibility that even an outright 'No' may only *delay*, not *prevent*, a move towards substantially more devolution.** The operative concerns in this instance will strongly resemble those of *immediate* greater devolution, as discussed below in Scenario 2.

6. Scenario 2: One Union, separate systems — a narrow 'No' vote

6.1. The second scenario, a *narrow* 'No' vote, is defined as a referendum result where more than 40% of Scottish voters vote 'Yes', and fewer than 60% vote 'No'—in technical terms, a *simple majority* for 'No'. There are no direct parallels in recent referendum results in the UK, although the most recent opinion polls which tested the two-option question that will be asked in the 2014 referendum indicate that, were the referendum to be held now, this is the outcome that would most likely result (see figure 6.1).[156] 'No' has retained a consistent edge since regular polling started in early 2012, but its lead over 'Yes' has started to become more volatile since the beginning of 2013.



Effects on the Scottish autonomy debate

6.2. The basic effect of a weak rejection of independence would be considerable disagreement over what this outcome means, as both 'No' and 'Yes' would see it as a sort-of-endorsement of their campaigning positions. The 'Better Together' campaign would frame it as a preference for the *status quo* and pressurise the UK Government to approach the post-referendum negotiations with a view to minimising the concessions granted to the Scottish Government—i.e., to adopt the attitude they would take in the case of an outright 'No' vote.

6.3. At the same time, 'Yes Scotland' and the SNP-led Scottish Government would cast the result as justifying *some form* of greater autonomy, on the basis that a near-even split in public opinion means that the 'significant minority' of 'Yes' voters cannot be ignored—i.e., they would try to push for the implementation as much of their independence agenda as is compatible with continued membership of Union.

6.4. A narrow 'No' result would be the tensest of the four possible outcomes, with negotiations brought about not by the practical need to make arrangements for the transition to independence (as with a 'Yes' vote) but by the more ideological need to devise a "political" compromise which both campaigns can frame as having adequately satisfied their aims going into them.[157] These would effectively be a microcosm of the debate between 'Yes' and 'No' in the lead-up to the referendum, and the implications of (respectively) meaningfully empowering Scotland and maintaining the 'social Union'.

6.5. It is thus likely that these negotiations would need even greater care than those after a 'Yes' result, and would need very careful compromise to avoid breaking down into unproductive acrimony, and to devise a result that takes into account criteria of 'good governance'. **The APPTG believes that this would be the 'price paid' for the exclusion of a third option for 'devo max' from the referendum question.**

[156] UK Polling Report, 'Scottish Independence Referendum' (accessed 3 July 2013).
[157] Campbell, *Interview*; Sinton, *Interview*.

6.6. It is worth recalling the Scottish Social Attitudes Survey's evidence that a settlement which gives Scotland full fiscal autonomy but reserves questions of defence, foreign policy, and the constitution to Westminster—i.e., more devolution but not full independence—would command majority consent among Scottish voters. **The APPTG recommends that both 'Yes' and 'No' campaigns should consider the negotiations after a narrow 'No' vote an ideal occasion to explore the kinds of 'third option' that might be possible. By doing so, they would be honouring the various Unionist parties' pre-referendum commitments to further devolution, and taking best advantage of the opportunity to 'make a real difference' to Scottish political economy.**

6.7. But it is also important to recall the Calman Commission's warning that there may be practical constraints which mean that such a conception of 'devo max' may be politically *desirable* but ultimately *infeasible*. The Commission emphasised the inconsistency of aspirations to extensive variation in fiscal policy between the regions of the UK with the retention of political unity at the highest level.

6.8. The specific incompatibility of exclusive Scottish control over taxation and public spending with maintaining "bonds of common social citizenship" across the Scottish-RUK border is also reflected more generally in the doubtful, limited separability of the areas of policy over which Scottish voters preferred Holyrood control from those they were content to see remain the prerogative of Westminster.

6.9. **The APPTG suggests that the purpose of future analysis of Scottish autonomy must be to establish, and critically test, the limits of the compatibility between fiscal devolution and political union. In particular, the APPTG argues that discussion of the fiscal relationship between Scotland and the UK must always be accompanied by discussion of the constitutional relationship between them.** As highlighted by Sir Menzies Campbell MP, it will not be possible to continue the *de facto* federalisation of fiscal policy within the UK without eventually raising the question of amending the UK's institutional and constitutional arrangements in a similar direction to 'keep up'.[158]

6.10. As yet, there is no unified Unionist position on how far devolution can be pushed without 'breaking' the Union.[159] The UK Government is still in the process of formulating an informed position on Scotland's current place in the Union in the *Scotland Analysis* series of reports: the reports are due to be published over the course of 2013 and the first part of 2014. The reports are intended to provide "comprehensive and detailed analysis of Scotland's place in the UK and how that would be profoundly affected by independence". Like the APPTG's project, it aims to "provide sources of information and […] enhance understanding on the key issues relating to the referendum"—but unlike the APPTG, it will not examine the different directions Scotland could take after the referendum.[160]

6.11. Instead, there are a number of competing suggested visions for post-'No' devolution which have been proposed independently by various Unionist parties, and other bodies which favour Scotland remaining in the Union. There are most detailed indications available so far as to the 'rethought' constitutional direction the UK could take. Broadly, they all attempt to provide some substantive content to the definition of vague term 'devo max', or an alternative compromise position that endorses the general principle of 'devo more'.

6.12. The Liberal Democrats built on the research of their 2006 Steel Commission to produce a set of fledgling proposals for fiscal federalism, which strongly resemble the 'devo-more' proposals brought out in a series of papers over 2012 by the Devo Plus group, led by the former Liberal Democrat MSP Jeremy Purvis, and associated with the thinktank Reform Scotland.[161] The thinktank IPPR has subsequently suggested a slightly different set of fiscal arrangements for 'devo-more' to Scotland, and the most recent contribution to the debate has been the Labour party's interim report, whose final conclusion is due in 2014.[162]

6.13. An overview of the fiscal recommendations of each set of proposals is provided below (see table 6.1).

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158 Campbell, *Interview*.

159 Tom Miers (Director, New Direction), *Interview*, 6 November 2012.

160 HM Government, *Scotland Analysis: Devolution and the implications of Scottish independence* (2013), p.12.

161 Steel Commission, *Moving to Federalism—A New Settlement for Scotland* (2006); Scottish Liberal Democrats Home Rule and Community Rule Commission, *Federalism: the best future for Scotland* (2012); Devo Plus, *A stronger Scotland within the UK* (2012); Devo Plus, *Improving social outcomes in Scotland* (2012); Devo Plus, *A New Union* (2012).

162 Alan Trench, *Funding Devo More: Fiscal options for strengthening the Union* (London: IPPR, 2013); Scottish Labour Devolution Commission, *Powers for a purpose—strengthening devolution* (2013), p.58; 'Labour to back more Holyrood tax powers', *Scotsman*, 6 April 2013; 'Labour MPs to snub Lamont over income tax plan', *Scotsman*, 14 April 2013.

Table 6.1: Proposed visions for post-'No' devolution

Source	Liberal Democrats	Labour	Devo Plus	IPPR
Devolution model	Federalism	Devo-more	Devo-more	Devo-max
Devolved	Income tax[163] Local taxes Land taxes APD Aggregates levy	Income tax[164] Local taxes Land taxes Vehicle excise duty APD Aggregates levy	Income tax[165] Local taxes Land taxes APD Aggregates levy	Income tax Employers' NIC Local taxes Land taxes APD Aggregates levy
Shared	Corporation tax (excl. North Sea oil)[166]	-	Corporation tax (excl. North Sea oil)[167]	VAT (assigned)[168] Excise duties[169]
Reserved	VAT NIC Excise duties North Sea oil revenue[170]	VAT Corporation tax NIC Other excise duties North Sea oil revenue	VAT NIC Excise duties North Sea oil revenue[171]	Corporation tax Employees' NIC
Public expenditure funding model	>60% devo/assigned <40% needs-based equalising grant[172]	50-55% devo/assigned 45-50% Barnett formula grant[173]	>66% devo/assigned <34% grant[174]	64-75% devo/assigned 25-36% needs-based equalising grant[175]

163 "Income tax paid by Scottish taxpayers should be almost entirely the responsibility of the Scottish Parliament. […] Income tax payable on savings and dividends should continue to be levied on a uniform basis across the UK, be deducted at source and a proportion of the UK receipts allocated to the Scottish Parliament." Scottish Liberal Democrats Home Rule and Community Rule Commission, *Federalism*, p.59.

164 "[A] strong case exists for devolving income tax in full, and we are minded to do so. … The advantage of devolving income tax—a revenue stream that provides a substantial, stable tax yield—is that it would provide a broader range of fiscal choices, enhancing accountability and responsibility for decisions made by the Scottish Parliament on taxation and public expenditure. It would also enable the Scottish Government to make the tax system more progressive." Scottish Labour Devolution Commission, *Powers for a purpose*, pp.8, 28.

165 "This means therefore the delivery of Devo Plus proposals for the devolution of: … the extension of the income tax power beyond the Scotland Act (2012) to cover power over setting of all rates within all bands, but not covering savings and distributions income." Devo Plus, *New Union*, p.20.

166 "Corporation Tax should continue to be operated and collected at the UK level, but the proceeds raised in Scotland should be assigned to the Scottish Parliament." Scottish Liberal Democrats Home Rule and Community Rule Commission, *Federalism*, p.60.

167 Scotland's control is restricted to "the setting of the rates of corporation tax only". Devo Plus, *New Union*, p.20.

168 "[A]ssigning 10 VAT points (of the present 20) would produce a substantial block of income for devolved governments, not subject to the constraints and problems of the block grant, and one which is both likely to grow over time and which gives them a direct incentive in securing further economic growth." Trench, *Funding Devo More*, p.29.

169 "It would be desirable to devolve taxation on alcohol and tobacco, given the relationships with devolved functions such as health, but there are formidable legal and administrative problems with doing so and this area needs further work." Trench, *Funding Devo More*, p.3.

170 "The Commission highlights the importance of the single regime for North Sea oil and gas extraction for the global industry and retains this regime at a United Kingdom level." Scottish Liberal Democrats Home Rule and Community Rule Commission, *Federalism*, p.10.

171 Excise duties and North Sea oil revenue are classed by Devo Plus as "[t]axes that can be a long term ambition for devolution but require fairly broad UK agreement among the nations and regions." Devo Plus, *New Union*, p.21.

172 Scottish Liberal Democrats Home Rule and Community Rule Commission, *Federalism*, p.60. This estimate includes GERS figures for the Scottish Government's gross operating surplus.

173 Scottish Labour Devolution Commission, *Powers for a purpose*, p.9. Based on GERS figures 2010/11. This estimate includes GERS figures for the Scottish Government's gross operating surplus.

174 Devo Plus, *Stronger Scotland*, pp.7, 43-5.

175 "The difference needs to be filled by a grant, which can be calculated using either of […] two approaches … [T]he balance lies clearly at present in favour of an ongoing use of resources rather than fiscal equalisation for the time being." Trench, *Funding Devo More*, pp.3-4, 43-4.

Effects on Scotland's fiscal arrangements

6.14. One of the first observations that springs out from this outline is that there is a remarkable amount of overlap and agreement between these proposals. In part, this is because some of the taxes in the 'Devolved' section are already under Holyrood control since the 1998 and 2012 Scotland Acts, specifically *local* and *land taxes*. As under the implementation of 'full Calman' in Scenario 1, all four proposals cede *APD* and *aggregates levy* to Holyrood, because they are a relatively insignificant part of the Scottish Government's finances, and their devolution was already approved by the Calman Commission.

6.15. But the major new point of commonality is the four proposals' unanimous recommendation to devolve *income tax*. The precise justifications given for this vary slightly between the proposals, but in general they rely on the observation that income tax revenues are relatively stable year-on-year, and that they make up a significant proportion of the revenue raised in Scotland—specifically, 23.3% of non-North Sea revenue (see §2.19). As such, the proposals see them as an obvious tool to give Scotland greater control over its finances, and to close the 'accountability deficit' between its tax-raising and spending power, not least because of the "direct connection with the population" which the Calman Commission observed in income taxation.[176]

6.16. The points of dissimilarity and contention between the proposals primarily concern *corporation tax*, as well as (to a lesser extent) *VAT* and *excise duties*. The justifications for reserving, or at most sharing, responsibility for corporation tax to the UK tier are broadly the same as those given by the Calman Commission—revenue volatility and deleterious tax competition (see §5.11)—so in this respect Scenario 2 is still relatively similar to Scenario 1. A degree of consideration is given to assignment of the corporation tax revenue raised in Scotland to the Scottish Parliament (Liberal Democrat proposal) *or* the power to vary corporation tax rates (Devo Plus proposal), but the operation and collection of corporation tax is retained at the UK level in all cases.

6.17. The Scottish Government continues to adhere to the view that devolution of corporation tax would be an integral part of any future autonomy settlement, as reiterated by John Swinney MSP in his recent evidence to the House of Lords Economic Affairs Committee:

> In relation to corporation tax, we have taken the view and still take the view that business taxation is an area where we can provide the opportunity to make Scotland an attractive place for investment.[177]

6.18. In light of this, this section assesses the relative merits of focusing the negotiations over control of tax policy after a narrow 'No' vote on full control of income tax (as the Unionist proposals imply) versus corporation tax (which the Scottish Government prefers), versus the points of difference between these proposals. Also, this section examines whether there might be any further possibilities for fiscal empowerment of the Scottish devolved institutions which these four offers have not considered, and extending their recommendations for NIC, VAT, excise duties, and North Sea oil revenue.

6.19. The two Unionist proposals that involve some sharing of responsibility for corporation tax are, in one respect, the reverse of each other. The Devo Plus proposal gives Scotland the power to vary rates, but the revenue raised still goes to UK fisc, while the Liberal Democrat proposal gives Scotland a proportionate share of the corporation tax revenue raised, but reserves the power to set rates to the UK tier. The Scottish government's preferred solution, fully devolved control of corporation tax, combines both Unionist suggestions, and adds the transfer of responsibility for operating and collecting corporation tax from HMRC to Revenue Scotland.[178]

6.20. Of these, the corporation tax assignment proposal is the smallest policy change from the *status quo*, but at the same time a significant structural and administrative shift. As suggested—though ultimately rejected—by the IPPR proposal, corporation tax assignment would require "apportion[ing] the profits generated by a company, in accordance with the proportion of the company's payroll arising from that part of the UK".[179]

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[176] Commission on Scottish Devolution, *Serving Scotland Better*, p.102.
[177] House of Lords Economic Affairs Committee, *Economic Implications*, Oral evidence—John Swinney MSP (11 December 2012), Q 898.
[178] Scottish Government, *Devolving Corporation Tax in the Scotland Bill* (2011), p.27.
[179] Trench, *Funding Devo More*, p.31.

The aim of such an approach would be to give the Scottish Government a more direct "stake in the fruits of [Scotland's] improved economic performance" by tying its financial capacity to the 'health' of the Scottish business community, and reducing its reliance on the Barnett grant from the UK.[180]

6.21. **The APPTG believes that achieving this aim sustainably for the long-term will require a more sophisticated method of calculating the proportion of corporation tax due to Scotland, although it is accepted that the *ad hoc* measure by "economy activity undertaken in Scotland" used by GERS and approved by the Office of National Statistics uses the best data currently available.**[181] The APPTG understands that HMRC are in the process of moving to regionalised tax receipt data, including for corporation tax, which will require businesses to "identify the proportion of their payroll employed in each part of the UK where corporation tax was devolved".[182] This may, of course, impose a significant administrative sunk cost on HMRC and businesses across the UK, and complicate the already onerous burden of submitting corporation tax returns for SMEs.

6.22. The assignment of corporation tax revenues—as with the full devolution of control over them—would result in an equivalent cut in Scotland's grant funding from the UK Government, and thus expose the Scottish budget to the full volatility of corporation tax receipts (see table 6.2).[183]

Table 6.2: Corporation tax volatility[184]

Year	2007-08	2008-09	2009-10	2010-11	2011-12
Corporation tax (excl. North Sea) (£m)	3,525	2,841	2,680	3,115	2,976
Total tax revenue (excl. North Sea) (£m)	44,815	43,502	41,664	44,287	46,297
Proportion of total non-North Sea revenue (%)	7.9	6.5	6.4	7.0	6.4
Corporation tax change year-on-year (%)		-19.4	-5.7	16.2	-4.5

6.23. **The APPTG agrees with the Scottish Government that Scotland's ability to manage such volatility would need the devolution package to include "appropriate cyclical borrowing powers" as well, although these would not need to be particularly extensive, given the relatively small size of the corporation tax component of total revenue.**[185] Corporation tax only makes up around 6.4% of Scotland's total non-North Sea revenue, so even a one-off year-on-year change in corporation tax revenue of 20% would only lead to a change in Scotland's total tax revenue of less than 1.5%.[186]

6.24. The corporation tax rate variation proposal is a more significant policy change, but ultimately requires exactly the same structural and administrative shift as tax assignment. Unlike assignment, where the *ad hoc* GERS calculation of corporation tax attributable to Scotland would suffice as a stop-gap until a more exact measure is found, rate-variation requires split Scottish-RUK profit accounting as a prerequisite. If anything, the burden on businesses and their tax advisers would become even greater, as it would be for businesses themselves to determine what proportion of their profits to attribute to 'Scottish' and 'RUK activity' on their single tax return to HMRC.

6.25. The question in this case then becomes whether varying the rate of corporation tax is ultimately desirable for Scotland. The UK main rate of corporation tax is in the process of being gradually lowered, from 23% as of

[180] Scottish Liberal Democrats Home Rule and Community Rule Commission, *Federalism*, p.10.
[181] Scottish Government, *Government Expenditure & Revenue Scotland: Detailed Revenue Methodology Paper 2011-12* (2013), pp.13-14.
[182] Trench, *Funding Devo More*, p.31.
[183] Scottish Government, *Devolving Corporation Tax*, p.8; Trench, *Funding Devo More*, p.31.
[184] Scottish Government, *Government Expenditure & Revenue Scotland 2011-2012* (2013), p.30.
[185] Scottish Government, *Devolving Corporation Tax*, p.27.
[186] Scottish Government, *GERS 2011-2012*, p.26.

1 April 2013, to 21% from 1 April 2014, and finally 20% from 1 April 2015.[187] The aim is to unify the main rate with the extant small profits and special rates, both at 20%, and to effect a degree of symmetry between corporation tax and the basic rate of income tax, at 20% for income under £32,010 (as of 2013-14).[188] There has been no indication that the Scottish Government would *immediately* seek to lower its corporation tax rate below 20% even if the capacity to do so had been devolved from Westminster, and even if the compatibility of its ability to vary the rate with EU state aid rules were conclusively confirmed by the ECJ.[189]

6.26. On the compatibility of corporation tax devolution with state aid rules, the question becomes whether Scotland counts 'enough' as an autonomous polity, according to the conditions of the ECJ Azores judgment (see §5.16).[190] The research of the House of Commons Northern Ireland Affairs Committee into the scope for devolving corporation tax to Northern Ireland concluded that

> [w]e are confident that the proposal to devolve the power to vary corporation tax to Northern Ireland can meet the criteria of the Azores judgment, although it is difficult to know for certain how the ECJ would apply the judgment in a new situation.[191]

Similarly, the Committee argued that

> [t]he Azores judgment, and the subsequent cases, indicate that the decision for Northern Ireland to have a rate of corporation tax, separate from the rest of the UK, could not be taken at Westminster. The power to vary the corporation tax rate would need to be devolved to the Northern Ireland Executive. Northern Ireland would bear the full financial responsibility for any reduction in tax revenue, and consequently Northern Ireland would not be compensated from HM Treasury for any tax loss.[192]

6.27. **The APPTG agrees with the Scottish Government that this analysis applies in full in the case of devolution to Scotland as well.**[193] However, some stakeholders interviewed suggested that there might be political obstacles imposed at the EU level that could prevent the required derogation being granted to the UK for application to Scotland—specifically, as a result of "latent antagonism" from the Spanish Government over the spillover effects of Scottish autonomy on constitutional tensions between Madrid and the Spanish regions.[194]

6.28. The main concerns regarding corporation tax rate variation are thus the sunk cost entailed by creating a rate differential between Scotland and the RUK. In order to justify the administrative costs of setting a separate corporation tax rate in Scotland, the Scottish Government must intend to introduce a rate that is *sufficiently different* (lower) to the main RUK rate to add real merit to going further than the ongoing UK cut to 20%.[195]

6.29. Given that businesses typically favour operating in regions with larger employment and asset bases, Scotland's likely extensive reliance on service industries for its economic foundations places it at a slight disadvantage relative to economies based more on goods-producing industries.[196] To attract businesses from the RUK and elsewhere to shift their headquarters to Scotland, and justify the sunk costs of moving as well as the additional transport and travel costs, the Scottish Government would have to commit to a maximum corporation tax rate of at most 16-17% for a rate cut to be worthwhile at all.[197]

6.30. The evidence from the Unionist side suggests that it is very likely that the RUK would seek to match any move to cut the corporation tax rate in Scotland.[198] Such a 'race to the bottom' between Scotland and the RUK would be made inevitable by the need to minimise the adverse effects on tax revenue of businesses cycling their profits through the lowest available tax regime via 'brass-plating' and transfer pricing in order to benefit from the new, hostile cross-border tax competition.

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187 HMRC, 'Corporation Tax rates'.
188 Nigel Mills MP, *Interview*, 22 October 2012; Teather, *Interview*, 16 October 2012; HMRC, 'Income Tax rates and allowances'.
189 Mawdsley and Payne, *Interview*; Scottish Government, *Devolving Corporation Tax*, p.11.
190 Teather, *Interview*, 16 October.
191 House of Commons Northern Ireland Affairs Committee, *Corporation Tax in Northern Ireland* (2011), p.26.
192 Ibid., p.27.
193 Scottish Government, *Devolving Corporation Tax*, p.9.
194 Teather, *Interview*, 16 October.
195 Whiting, *Interview*, 9 October 2012.
196 Mills, *Interview*.
197 Teather, *Interview*, 16 October; Scott McNab, 'Scottish independence: Corporate tax slash pledge', *Scotsman*, 22 May 2013.
198 Sinton, *Interview*; House of Lords Economic Affairs Committee, *Economic Implications*, Oral evidence—Rt Hon Alistair Darling MP (24 October 2012), Q 577.

6.31. Corporation tax, as 6.4% of Scotland's non-North Sea revenue, and 5.7% of the UK's total tax revenue, is both a sufficiently small component of both governments' revenue that aggressive competition will not greatly harm either's overall tax take, but still also sufficiently large for competition over it to be worthwhile. Scotland-RUK corporation tax competition is thus very likely to take place, and also likely to ultimately harm Scotland more, as the RUK can better afford to compete through rate-undercutting due to its deeper and better-established tax base. The implication is that there is likely to be a lower bound on how reduced a corporation tax rate Scotland can set—realistically, not far off the Irish 12.5% rate which the SNP have suggested Scotland should eventually emulate.[199]

6.32. The Scottish Government's position has consistently been to lobby for full devolution of control over corporation tax from Westminster to Holyrood—in effect, a combination of the assignment and tax-varying proposals. This combination is what was assessed by the IPPR model, where "[d]ifferent rates [of corporation tax] could […] be levied on [*sic*]—and paid to—the respective governments".[200]

6.33. But full devolution would also include the transfer of operating and collecting control from HMRC to Revenue Scotland, which would sacrifice some of the remaining advantages left over from the uniform corporation tax regime, including the need for businesses to submit only a single return to HMRC. As businesses would now have to submit a second return to Revenue Scotland as well, this would impose a significant added administrative complication and sunk cost—unless Scotland were to include an arrangement to outsource the corporation tax side of its tax administration to HMRC (even in a transitional capacity) in its post-'No' negotiations.

6.34. **The APPTG notes that a significant body of expert opinion has identified a deeper long-term problem with corporation tax, namely that institutional difficulties with ring-fencing the profits of large (especially multinational) businesses to tax mean that the profit-shifting practices which the UK Government is so keen to avoid are ultimately impossible to prevent.** The long-term trend for corporation taxes is thus downwards, to the extent that Mike Denham, Research Fellow at the TaxPayers' Alliance, estimated that a '30-year view' of corporation tax would see rates reduced, certainly across Europe, to token levels not far above 0%.[201]

6.35. The concern here is the effect of long-term shrinking corporation tax revenues—much more than their year-on-year volatility—on Scotland's overall fiscal position, in particular on the fiscal sustainability and hence credibility of its model of social democracy.[202] **The APPTG sees this as the most convincing indication that devolution negotiations should not focus too heavily on corporation tax, at the expense of much-needed discussion of other aspects of fiscal autonomy. Nonetheless, the APPTG recognises that corporation tax would be a useful short-term source of revenue for Scotland, with the caveat that both Scotland and the UK must give serious thought to finding a replacement for corporation tax in future, in order to stay globally competitive.**

6.36. The question of which form of corporation tax devolution—assignment, rate variation, or full control—is preferable is largely a question of balancing the expected short-term administrative cost against the expected long-term economic gains. **The APPTG accepts that there are legitimate concerns with corporation tax devolution over 'competition for competition's sake', and emphasises the importance of striking a balance between Scotland varying rates to demonstrate its policy independence from the UK and implementing changes that are effective in promoting growth in the Scottish economy.**

6.37. But at the same time, the APPTG recognises that extensive control over taxation on businesses and their profits is an integral—even if temporary—tool for Scotland to have as part of its future ability to build a reliable tax base. **The conclusion from this is that, as long as Scotland remains within the Union, it can be granted—and could proactively use—the capacity to set differential corporation tax rates, but also that there is a very narrow margin for it to operate in (12.5-17%) as far as setting corporation tax rates to undercut the UK's rate is concerned.**

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[199] Kay, *Interview*; 'Scottish government makes corporation tax case', *BBC News*, 16 August 2011.
[200] Trench, *Funding Devo More*, p.31.
[201] Mike Denham (Research Fellow, TaxPayers' Alliance), *Interview*, 22 October 2012.
[202] Teather, *Interview*, 16 October.

6.38. **The APPTG is very clear that corporation tax cannot be the "be all and end all" of the fiscal autonomy debate.**[203] Not only are there difficulties with devolving it, as well as institutional opposition at the UK level to doing so, but it is far from the most significant part of the Scottish finances. Income tax, VAT, National Insurance Contributions, and (taken together) excise duties all account for a greater proportion of tax revenue raised in Scotland (see table 6.3).

Table 6.3: Current revenue Scotland (£m)[204]

Year	2007-08	2008-09	2009-10	2010-11	2011-12	2011-12 (%)
Income tax	11,267	10,642	10,364	10,668	10,790	23.3
Corporation tax (excl. North Sea)	3,525	2,841	2,680	3,115	2,976	6.4
NIC	7,840	7,992	7,915	7,978	8,393	18.1
VAT	7,917	7,438	7,264	8,343	9,554	20.6
Excise duties[205]	4,256	4,287	4,643	4,808	4,996	10.8
Total tax revenue (excl. North Sea)	44,815	43,502	41,664	44,287	46,297	(100.0)

The APPTG suggests that this ought to have significant implications for the fiscal policy priorities to be discussed in the negotiations after a narrow 'No' vote.

6.39. By far the largest component of Scottish tax revenue, income tax, seems likely to be *uncontentiously* part of any future autonomy settlement—although it would still be for the Scottish Government to insist that this be the case. There is little doubt that income tax is one of the most useful tools in the Scottish Government's fiscal arsenal, as the tax regime which Scotland would inherit from the UK relies on the principle of raising revenue by attracting many businesses with many workers paying PAYE.[206]

6.40. The main observation to be made here is that, as yet, the Scottish Government has not chosen to make use of the Scottish Variable Rate—its current equivalent version of this tool—nor has it given any indication at what level it will set the Scottish Rate of Income Tax when it comes into effect in April 2016. **Although there have been suggestions that Scotland would need to show that the SRIT works before more powers would be devolved, the APPTG believes that the settlement which included full devolution of income tax control would be likely to be agreed well before the full effects of the Scotland Act 2012 become clear.**[207]

6.41. It is worth observing that the ±3% leeway permitted by the SVR suffers from the same problem as the Scottish Government's notional control over varying the corporation tax rate, in that it simply does not permit a rate-distinction between Scotland and the RUK that is *sufficiently different* (higher or lower) for a change to be worthwhile.[208]

6.42. Given the high labour mobility between Scotland and the RUK, and the high relative preponderance in Scotland of basic-rate taxpayers (86% of all Scottish taxpayers), using the SVR to *add* up to 3 'points' onto each income tax band might have triggered a slow shrinkage of the total Scottish income tax base without

[203] Whiting, *Interview*, 6 November.
[204] Scottish Government, *GERS 2011-2012*, p.30.
[205] Fuel duties, tobacco duties, alcohol duties, betting and gaming duties, vehicle excise duty.
[206] Teather, *Interview*, 16 October.
[207] Brunton, *Interview*.
[208] Teather, *Interview*, 16 October.

necessarily raising a large amount of additional revenue.[209] At the same time, *subtracting* up to 3 'points' would have (at least initially) significantly reduced Scotland's revenue and made it more difficult for it to meet its existing spending commitments, without necessarily guaranteeing an influx of the higher- and additional-rate taxpayers whose contributions would make up a significant portion of total income tax receipts.[210]

6.43. Although the incoming SRIT at least gives Scotland the *option* of making much more significant changes to tax rates—e.g., a low Scottish rate of 5 pence, or a high one of 15 pence, on top of the (UK rate – 10 pence) calculation—it would still face similar problems of Scotland-RUK tax competition as corporation tax. Income tax, as 23.3% of Scotland's non-North Sea revenue, and 25.6% of the UK's total tax revenue, is so large a component of both governments' revenue that aggressive competition carries significant risk of harming either's overall tax take, but also for that reason is all the more potentially lucrative.

6.44. As identified by the Scottish Government Finance Committee, as well as by the Office for Budget Responsibility, it is difficult to forecast precisely what the effect of changes in SRIT away from the standard assumption of a 10p rate would be.[211] Under a rough counterfactual estimate against the latest fiscal data for Scotland, however, an SRIT of 5p would reduce the Scottish Government's total tax revenue by 4.7%, and lead to a *fundamental rebalancing* towards alternative sources of revenue to fund the significant gap this would leave in its finances (see table 6.4). An SRIT of 15p, by the same logic, would increase total tax revenue by the same amount, possibly to the extent of making Scotland *over-reliant* on income at the expense of other sources of tax revenue.

Table 6.4: Estimated hypothetical SRIT variation applied to 2011-12 figures (£m)[212]

SRIT (pence/£)	10p	5p (est.)	9p (est.)	11p (est.)	15p (est.)
SRIT revenue	4,330	2,165	3,897	4,763	6,495
Total income tax revenue in Scotland	10,790	8,625	10,357	11,223	12,955
Total tax revenue (excl. North Sea)	46,297	44,132	45,864	46,730	48,462
Revenue gained/lost from rate variation	-	-2,165	-433	433	2,165
Revenue gained/lost from rate variation (%)	-	-4.7	-0.9	0.9	4.7
Income tax as share of total tax revenue (%)	23.3	19.5	22.6	24.0	26.7

6.45. Both of these radical approaches to the SRIT are also associated with political and economic problems beyond the question of their immediate ability to help Scotland fund its short-term obligations. Given the current UK Government's prioritisation of combating tax avoidance and more general EU moves against tax havens, it is unlikely that Scotland could set a Scottish rate of significantly less than the deducted 10 pence without incurring political retribution or a legal challenge. At the same time, Scotland could not (initially) set a rate significantly above 10 pence for fear of driving high-income taxpayers south of the border, as with the SVR, and thereby jeopardising its long-term financial sustainability.

6.46. A less immediately ambitious approach would be to aim for a variation of ±1p in the SRIT, as this would lead to more manageable total tax revenue fluctuations of ±0.9%, as well as maintaining the overall stability of income tax as a share of revenue. **Since the overall guiding principle of Scottish income tax policy**

[209] HM Revenue & Customs, *Income Tax Liabilities Statistics 2010-11 to 2012-13: Tables 2.1-2.7* (2013), p.23.
[210] Iain McLean (Professor of Politics, Nuffield College, University of Oxford), *Interview*, 16 October 2012.
[211] Office for Budget Responsibility, *Economic and fiscal outlook: Scottish tax forecasts* (2013), pp.4-9; Scottish Parliament Finance Committee, *8th Report 2013 (Session 4): Report on the implementation of the financial powers in the Scotland Act 2012* (2013).
[212] All figures derived from Office for Budget Responsibility, *Economic and fiscal outlook*, and Scottish Government, *GERS 2011-2012*, p.30.

should be a focus on stability, at least in the short term, the APPTG therefore suggests that the probable range for SRIT is likely to be around 9-11 pence. Given this somewhat token divergence from the deducted 10 pence, the APPTG has some sympathy with the view that rate-variation *by itself* is unlikely to be a very useful policy tool for the Scottish Government to have.[213]

6.47. A far more significant power, implied by the full devolution of income tax endorsed by all four Unionist proposals, is that of changing the income tax *bands* in force in Scotland. Currently, the SRIT cannot be varied by bands, which traps Scotland in the same general model of tax-progressivity as the RUK.[214] The power to define tax bands would allow the Scottish Government to reshape the structure of its income tax regime to, for example, decrease the burden on lower-income taxpayers (by lowering the rate and/or increasing the tax threshold) *and* increase the burden on higher-income taxpayers (by raising the rate and/or lowering the tax threshold).

6.48. Of course, this would put Scotland in a much more fundamental, almost *ideological*, state of competition with the RUK, but it would now have greater flexibility to respond, and to do so in a more nuanced way, than under the SVR or SRIT, where Scotland is simply a more or less competitive version of the UK income tax model. The main caveat would be whether such ideological competition between a presumably more 'social-democratic' Scotland and a more 'free-market' RUK is compatible with the similarity of political-economic worldviews implied by the idea of the 'social Union'. **However, the APPTG considers the ability to define the principles on which a tax and social security system operates a sufficiently important criterion in the establishment of a distinct identity for the Scottish polity for this concern to be waived.**

6.49. The most explicit manifestation of the 'social Union' in the tax system is the system of National Insurance Contributions, which make up (at different times) the second- or third-largest component of tax revenue in Scotland. As an additional tax on income, NICs are used to fund benefits that are both designed, and perceived, to be *universal* across the UK, even if some of their structural operations are *de facto* regionally devolved—old age pensions, contributory social security, and the NHS.[215]

6.50. This universality would be disturbed or broken if NICs were devolved to the UK's subsidiary regions, unless there were significant parallel moves to devolve "regulation of the economy in general, and the labour market in particular", especially the elements of social security which are still universal across the UK.[216] **The APPTG notes that social protection expenditure (welfare benefits) are the only part of aggregate government expenditure still largely reserved to the UK tier, and suggests that significantly greater devolution of this would leave Scotland *de facto* all but independent.**[217] In such a case, Scotland and the RUK would have to negotiate a reciprocity agreement on social rights such as that existing between EU member states—or, more relevantly, between the UK and Ireland—in order to maintain the parity of treatment between Scottish and RUK taxpayers required as part of their common citizenship of the UK.[218]

6.51. It is important to note that NICs are split into employee and employer contributions, which function respectively as *de facto* income and business taxes. The APPTG agrees with the analysis of the IPPR proposal that employers' NICs could be devolved to Scotland along similar lines to corporation tax, and suggests that there is a high degree of merit from an administrative and tax simplification perspective in a 'devolution package' which would transfer control over business taxation from the UK to the Scottish tier *en bloc*.[219] **The APPTG accepts that, as with corporation tax, there will always be a risk of competition between Scotland and the RUK, but argues that, should regional economic competition develop within the UK, rates of employers' NICs are unlikely to be the most significant locus of rivalry.**

6.52. **The only likely situation under which employees' NICs would be devolved would be if they were fused into income tax entirely, as was briefly considered in 2010, although the APPTG does not**

213 Whiting, *Interview*, 9 October.
214 Brunton, *Interview*; Institute of Chartered Accountants of Scotland, *Scotland's Tax Future: The Practicalities of Tax Devolution* (2012).
215 McLean, *Interview*.
216 Trench, *Funding Devo More*, p.28.
217 Scottish Government, *GERS 2011-12* (2013), p.53.
218 Kay, *Interview*.
219 Trench, *Funding Devo More*, p.28.

consider this likely to happen before a further autonomy settlement (including full income tax devolution) would be agreed. In fact, without such a separate 'national insurance' system, the symbolic and functional representation of the 'social Union' in the tax system would be largely lost, which might make the Unionist side *less* likely to accede to the *full* devolution of income tax on account of the ideological competition between tax regimes to which it might lead.

6.53. There is certainly a case to be made for a wide-reaching reform of the NIC system, but it lies beyond the remit of this report, apart from the comment that it should be possible for Scotland to coordinate with the RUK on any such reform to either *opt out from*, or *inherit*, the changes ultimately made.[220] In general, such reform would see a restoration of the direct link between the NIC-specific *contributions* and the particular *benefits* (pensions, healthcare) they are intended to finance.[221] Since responsibility for healthcare policy and spending is already devolved to Scotland, the devolution of a healthcare-specific contributory system would in principle be relatively uncontroversial.

6.54. However, applying the same to pensions would entail extensive administrative and philosophical complications, deriving from the EU practice that every country in which a pension is earned must contribute to a given employee's pension.[222] In the UK, a lack of sufficiently granular historical record-keeping means that it would be very difficult to determine accurately where within the UK (i.e., in Scotland as opposed to elsewhere) people have worked. **On the basis that it would be extremely difficult to ensure parity of treatment between Scottish and RUK taxpayers such that their common UK citizenship would still be of meaningful value once this aspect of the 'social Union' is devolved, the APPTG suggests that employees' NICs would need to be reserved to the UK tier.**

6.55. The status of VAT, the next largest component of Scotland's tax revenue, is perhaps the simplest of all the components of UK tax revenue. Under EU rules, VAT must be uniform in each member state, such that "within the territory of each Member State similar goods and services bear the same tax burden", in the interests of maintaining "neutrality in competition".[223] It is thus clear that, while the UK remains in the EU, the power to vary VAT rates could not be devolved to Scotland or any other subsidiary region. **However, the APPTG endorses the suggestion of the IPPR proposal that a "large proportion" of the VAT revenues attributable to Scotland should be assigned directly to the Scottish Government, and suggests that this proportion could exceed the 10 'points' which this proposal recommended as an *ad hoc* measure.**[224]

6.56. Bearing in mind that 3 VAT points are hypothecated to the EU as part of the 'common resources' system, and that the current rate of 20% has only been in force since January 2010, with previous levels of 15% (pre-1991, 2008-10) and 17.5% (1991-2008), the APPTG recommends finding a more flexible formula to determine the proportion assigned to Scotland. For example, the APPTG suggests a formula of the form

$$VAT_{Scot}(\%) = VAT_{UK}(\%) - h_{EU} - r_{UK},$$

where h_{EU} is the amount hypothecated to the EU (currently 3 points), and r_{UK} is the amount reserved to the UK, to be determined as part of the fiscal autonomy negotiations.

6.57. North Sea oil revenue is reserved to the UK level by all four Unionist proposals, although the Devo Plus proposal classes it as a component of tax revenue that "can be a long term ambition for devolution", subject to further negotiation and "fairly broad UK agreement among the nations and regions".[225] The chief motivation for its retention to the UK tier is the benefit of having a single regime for oil and gas extraction, and its potential (albeit declining) to support "the establishment of an oil fund, when fiscal conditions improve, for investment across the UK".[226]

[220] Ibid., p.14.
[221] Philip Booth (Editorial and Programme Director, Institute of Economic Affairs), *Interview*, 21 September 2012.
[222] Kay, *Interview*.
[223] European Union, Council Directive 2006/112/EC, §7.
[224] Trench, *Funding Devo More*, pp.3, 28-9.
[225] Devo Plus, *New Union*, p.21.
[226] Scottish Liberal Democrats Home Rule and Community Rule Commission, *Federalism*, p.10.

6.58. For Scotland, the main motivation for devolution is that a 90.5% geographical allocation of oil revenue would increase Scotland's tax revenue by between £5.9bn and £11.8bn per year, increasing its tax revenue by between 14.2% and 27.0% in the last 6 years, with expected further revenue from 2017-18 to 2040-41 of £56bn.[227] **The APPTG observes that the extreme volatility of the oil revenue, drive in part by fluctuations of both the US$ oil price and the UK£ exchange rate, would very likely need to be compensated for by the further extension of cyclical revenue borrowing powers, as with the assignment or devolution of corporation tax.**

6.59. Excise duties, as the final major component of Scottish tax revenue, occupy an unusual space in the autonomy debate, due partly to the somewhat disparate contents of their tax base. Vehicle excise duty, as suggested by the Scottish Labour proposal, is an obvious candidate for devolution, both because doing so would be administratively relatively straightforward, and because transport policy is *de facto* devolved to Scotland already.

6.60. The same applies, albeit to a lesser degree, to alcohol and tobacco duties, which overlap extensively with the regional devolution of the NHS and health policy, but where devolution would lead to administrative problems of calculation and levying, as well as limited policy effectiveness, due to their being levied at the point of production or importation, not the point of sale or consumption.[228] Assigning alcohol and tobacco duties would necessarily rely on the somewhat *ad hoc* current estimations of how much of each is attributable to Scotland, as consumption data for alcohol especially is difficult to calculate accurately.[229] It would arguably be best seen as a relatively plausible intermediate stage "pending some fuller devolution" or a more fundamental reconsideration of the role of both duties in wider UK social policy.[230]

6.61. Betting and gaming duties are more problematic to devolve, as the service they are levied on is highly mobile, and there would be potential problems of competition between subsidiary jurisdictions, and hence avoidance, in a policy areas that is not (as yet) devolved to Scotland.[231] Assignment would be equally *ad hoc* as for alcohol and tobacco duties, as the taxable transaction is often "extremely difficult to separate […] geographically", but could be done in principle as part of the more general move to strengthen the Scottish Parliament's financial accountability.[232]

6.62. Fuel duty is the least devolvable excise duty, as it is currently the subject of EU focus for tax harmonisation (including anti-competition measures and minimum taxation levels), in line with the energy and climate change goals of the Europe 2020 Strategy, making it unlikely that the UK would be granted the derogation required for fuel duty to be devolved to Scotland.[233] *Ad hoc* assignment of fuel duty revenues is thus the maximum level of responsibility Scotland could be granted while the UK remains a member of the EU.

6.63. **The APPTG notes that the question of whether, and how, to devolve excise duties is also linked (again) to the question of how far to maintain the 'social Union'.** The goods and services on which excise duties are levied are ones which, in some sense, represent or reflect behaviour which the UK Government has decided must be influenced, or regulated, using public policy—either environmentally harmful activity or addiction. The 'common view' on the moral value of such behaviour, and on the way it should be treated politically and financially, is an important part of the normative, or cultural side of shared UK citizenship—just as the equivalent is true for shared EU membership in the case of fuel duty.

6.64. If these duties were regionally devolved within the UK and significant differences emerged in the policy treatment of these activities, this would add yet another instance of 'ideological competition' to the relationship between Scotland and the RUK. The case of excise duties is one of the clearest indications that the adoption of a *completely* unique, separate Scottish 'guiding view' of society is incompatible with even a *minimal* degree of constitutional subordination to the UK tier of governance via the 'social Union'.

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[227] Scottish Government, *GERS 2011-2012*, p.30; David Maddox, 'Scottish independence: oil forecasts down £11bn', *Scotsman*, 18 July 2013.
[228] Trench, *Funding Devo More*, p.32.
[229] Devo Plus, *Stronger Scotland*, pp.26-7.
[230] Trench, *Funding Devo More*, p.34.
[231] Ibid., p.31.
[232] Devo Plus, *Stronger Scotland*, p.26.
[233] European Commission, *Proposal for a Council Directive restructuring the Community framework for the taxation of energy products* (COM/97/0030 final – CNS 97/0111).

6.65. For each of these taxes, the main question in the case of the devolution of control over them to Scotland is *whether*, and *to what extent*, a (more) autonomous Scotland *would in fact vary them*.[234] As observed by Rt Hon Danny Alexander MP, the Chief Secretary to the Treasury, there is extensive technical scope for variation within the single market within the UK, as evidenced by the high diversity of local taxes in the USA.[235]

6.66. Yet at the same time, as noted by Lord Lawson of Blaby, the former Chancellor, tax variation is rarely the "sort of thing that wins votes"—rather, political campaigns focus extensively on the possibilities in public spending, over which Scotland already has extensive control.[236] This, in part, may explain the reticence of the Scottish Government to exercise the tax-varying powers it already has.

6.67. But the devolution debate is as much a discussion over principle as over practice. The rationales of sovereignty and accountability which prompt the Scottish drive for greater autonomy are less about 'difference for difference's sake' than about "giving Scotland the levers and tools to address problems that it faces"—giving Scottish institutions not only the *responsibility* for dealing with these problems, but also the *choice* of how to do so.[237]

6.68. **The APPTG is unpersuaded that centralised cohesiveness has sufficient innate advantages over devolved competitiveness and complexity, or that the UK tax system is sufficiently streamlined and efficient to enjoy such extreme economies of scale, to outweigh the calls for further fiscal devolution.**[238] In this respect, the importance of maintaining an identitarian link between 'Scottish tax' and 'Scottish spending' pushes the balance between the competing pulls of tax *simplification* and tax *devolution* unquestionably towards the devolution end.

6.69. For any tax where it is decided that it *can* be devolved, and therefore *ought* to be devolved, it is important to remember that what can be varied under *full* devolution is not restricted to simply tax *rates*. Of course, the rate-setting power is an integral part of fiscal devolution, and—since rates cannot be differentially set for different regions from London—the devolution of *responsibility* for a tax is an important prerequisite to the devolution of the power to vary its rate(s).[239] Rate-variation is one of the main tools by which any country or region can influence its international fiscal competitiveness, and to affect its budget balance and overall tax base—with obvious implications for its borrowing conditions and public expenditure possibilities.[240]

6.70. But full devolution also entails the ability of a subsidiary tier to vary both tax *allowances/discounts* and tax *bands*. While the *levels* of tax allowance would be relatively straightforward to hand over to Scottish control, decisions regarding whether to have tax allowances *at all* are much more fundamental, and again raise questions of the compatibility of this form of tax-variation with EU state aid rules.[241] As seen above with income tax (see §§6.43-8), Scotland would need control over tax bands as well as tax rates, in order to have scope for a more nuanced shaping of the progressiveness of the tax system, and to cast it in a form that is more appropriate to Scotland's internal demographics.

6.71. Both forms of variation would have significant implications for competition between Scotland and the RUK, and would raise questions over the extent of what remains of the 'social Union' between them. It is certainly clear that Scotland would *not* receive control of the definition of tax *bases* under *any* devolution settlement, because this would be especially likely to encourage 'gaming' of the Scottish and RUK tax regimes and hence (again) jeopardise the 'social Union'.

6.72. As far as these additional forms of tax-variation is concerned, it is hard to tell whether they would be part of a future autonomy settlement after a narrow 'No' vote. Without clear statements of policy intentions from both Scotland and the UK about future developments on these aspects of tax policy, they would most likely end up a matter for negotiation**. The APPTG takes no view on whether tax discounts or bands *ought***

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[234] Sinton, *Interview*.
[235] Ibid.
[236] Ibid.
[237] Mawdsley and Payne, *Interview*.
[238] Max Wind-Cowie (Head of the Integration and National Identity programme, Demos), *Interview*, 7 September 2012; Booth, *Interview*.
[239] Mills, *Interview*.
[240] Brunton, *Interview*.
[241] Teather, *Interview*, 9 October.

to be devolved, and merely suggests that it is possible that only rate-varying powers *might* ultimately be devolved for taxes deemed to be fundamental to the maintenance of the 'social Union'.

6.73. Increasing Scotland's fiscal autonomy on the tax side would not be possible without also increasing its *borrowing* capacity. As seen from the devolution of revenue components such as corporation tax or North Sea oil revenue, greater Scottish autonomy, responsibility, and accountability would have to include alternative ways to counteract the potential greater volatility of its revenue stream then the block grant under the Barnett formula. Borrowing powers are the clearest way of doing so, as observed by the IPPR's analysis:

> Devolved tax-setting powers without borrowing powers expose devolved governments to serious risk without giving them one of the tools necessary to manage that risk … Devolved borrowing powers are part of devolving fiscal responsibility.[242]

6.74. Of course, an international comparison demonstrates the potential risks of devolving borrowing powers without retaining any accountability of the subsidiary tier to the central government: the profligacy of the Spanish regions has been a major exacerbating factor in the current Spanish sovereign debt crisis.

6.75. **But the APPTG does not see increased Scottish borrowing powers as *necessarily* problematic.** Learning from the Spanish precedent, borrowing powers could be heavily devolved within the UK, accompanied by stringent controls and caveats not unlike those already in place under the 1998 and 2012 Scotland Acts, which trigger a 'freezing' or even revoking of Scotland's borrowing powers if certain standards of fiscal responsibility are inadequately met.

6.76. **The APPTG observes more generally that several of the powers which the SNP Scottish Government could push for in the case of a narrow 'No' vote, as outlined in this scenario, would have to be transferred 'hand in hand' to be fully effective.** For instance, income tax devolution would have to accompany corporation tax devolution in order to smooth the effects of raising/lowering overall revenue reliance on one or the other—especially if this were used to introduce a new, different 'Scottish Way' model of social democracy.

6.77. **The APPTG notes that there are important procedural questions over the *order in which powers are devolved*, and suggests that future analysis should carefully examine the possibility of creating a roadmap to guide how any move to giving Scotland greater autonomy should be implemented.[243] The APPTG will provide its own version of such a roadmap in a future report.**

Constitutional implications

6.78. The final consideration in this scenario is the link between fiscal autonomy and the 'deeper' constitutional question of how a more empowered Scotland should fit into the overarching UK polity. *Rather than the transfer of individual, discrete fiscal powers under a devo-more approach, would Scotland and the RUK be better served by a full overhaul, and institution of a full federal system?* As observed by Reform Scotland, the UK approach of asymmetric devolution is a somewhat unstable midpoint between the two typical 'poles' of *unitary* and *federal* government, a midpoint which has yet to give voters in England "a reason to engage in the debate".[244]

6.79. The various components of fiscal devolution discussed above could be incorporated into a broader examination of the powers entrenched in the various tiers of governance, and a search for a stable, sustainable mechanism to foster a productive co-relationship between England and the Celtic regions, under the auspices of the UK as a constitutional 'holding company' or "umbrella organisation".[245]

6.80. There have been a number of objections raised to the prospect of a full-scale federalisation of the UK which merit a brief mention here. Given the rejection of regionalism within England, and the strong and growing English national identity, any federal system would involve attempting to create some form of parity or co-equivalence between one large region and three considerably smaller ones (under the *status quo*).

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[242] Trench, *Funding Devo More*, p.24.
[243] Booth, *Interview*; Brunton, *Interview*.
[244] Mawdsley and Payne, *Interview*.
[245] Teather, *Interview*, 16 October.

6.81. The need to prevent England dominating its co-constituent regions would have to be balanced with the equal and opposite need to reflect the majority status of the English population within that of the wider UK—a situation for which the latent rancour of federal relationships in (for instance) Belgium or the former Czechoslovakia are extremely instructive.[246]

6.82. The only clear way to even the balance would be to pursue the administratively plausible but currently extremely hypothetical prospect of significantly increasing policy devolution to regions which are far less interested in it than the three devolved nations have historically been: Greater London, Cornwall, Yorkshire, or any other plausible candidates.[247] **At the same time, the APPTG suggests that federalism would be self-defeating if it were to strangle the localist drive in current UK Government policy, and recommends that more analysis is produced on possible ways to achieve a balance between these various tendencies in practice.**[248]

6.83. The final point to consider under this scenario is that the tentative, medium-term pressure for the Barnett formula for calculating the block grant from Westminster to the Celtic regions to be replaced under Scenario 1 is likely to become much more immediate under this scenario. In particular, if the SNP-led Scottish Government push for the maximum degree of 'devo more' possible after a narrow 'No' vote, a reassessment will be needed of the political and economic justification for having a grant in a situation where the bare minimum is reserved to the UK tier. Symbolically, as discussed by the House of Lords Economic Affairs Committee, the block grant has historically been Scotland's 'trade-off' for not having control of its allotted share of the revenue from the North Sea oil reserves.[249]

6.84. Furthermore, analysis by Corin Taylor, Senior Economic Adviser at the Institute of Directors, suggests that in the period 1985-2009 there has been a close numerical equivalence between the size of Scotland's 'spending gap', and hence the value of the grant supplement to tax revenues to fund total expenditure in Scotland (£128bn), and the total value of a 90% geographical share of North Sea oil revenue (£134bn).[250] But if North Sea oil revenues are also devolved to Holyrood control, they will no longer 'work' as a suitable explanation—to RUK as much as to Scottish voters—of why the grant is still in place.

6.85. The option which has been recommended by the IPPR and the House of Lords Select Committee on the Barnett Formula to replace the current calculation is a system of *resource equalisation*, where the grant payment seeks to mitigate spending differences per head between the UK's regions. The principle of this option is closely associated with the ideal of the 'social Union', on the basis that UK citizens in different regions should be "equally placed" to benefit from services paid for through public expenditure, and that the UK Government "must be able to provide similar levels of services to individuals" in order for common citizenship to be a meaningful concept.[251]

6.86. In this respect, the 'needs-based' grant connects well with the reservation of tax elements like NICs and (some) excise duties, as fiscal manifestations of the shared social *values* of the Union. **The APPTG endorses the need for a simple, workable methodology for calculating relative need, and recommends the application of the seven indicators identified by the Holtham Commission for the recalculation of the grant formula.** These are: (1) number of children; (2) number of older people; (3) ethnicity; (4) income poverty; (5) ill health; (6) sparsity; and (7) the London weighting (obviously inapplicable to Scotland).[252]

6.87. The alternative to resource equalisation, *fiscal equalisation*, where the grant payment seeks to compensate for differences between a region's tax base and the 'average' tax base of the UK as a whole, is more typically a feature of "more decentralised federal systems", and as such is unsuited to the UK approach of asymmetric devolution without a parallel full-scale Constitutional Convention.[253] Moreover, the APPTG notes that EU state aid rules "rule out any system of fiscal equalisation that takes into account a corporation tax base or

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[246] Henderson, *Interview*; Frank Field MP, *Interview*, 21 November 2012.
[247] Teather, *Interview*, 16 October.
[248] Mawdsley and Payne, *Interview*; Field, *Interview*.
[249] House of Lords Economic Affairs Committee, *Economic Implications*, pp.14-15.
[250] Corin Taylor, 'The fiscal consequences of Scottish independence', *Big Picture* No. 11 (2011), p.16.
[251] Trench, *Funding Devo More*, p.36.
[252] Independent Commission on Funding & Finance for Wales, *Fairness and accountability: a new funding settlement for Wales* (2010), p.20.
[253] Trench, *Funding Devo More*, pp.35, 38-9.

revenues", which means that fiscal equalisation as a basis for the block grant is incompatible with the devolution of corporation tax to Scotland.[254] **Since the SNP have so strongly prioritised the devolution of corporation tax, the APPTG observes that fiscal equalisation would not be workable as long as the UK retains its current status as an EU member state.**

Conclusion

6.88. The APPTG refers to the substantive implications of this result as *aspirational devolution*. From the analysis in this section, the APPTG characterises two forms of further autonomy for which the Scottish Government would be able to push in the case of a narrow 'No' vote.

6.89. An overview of both forms of maximal autonomy is given below (see table 6.5).

Table 6.5: Two forms of Scottish autonomy

Version	Stable maximum	Technical maximum
Devolution model	Devo-max	Federalism
Devolved	Income tax Employers' NIC Local taxes Land taxes Vehicle excise duty APD Aggregates levy	Income tax Corporation tax Employers' NIC Local taxes Land taxes Vehicle excise duty Tobacco and alcohol duties APD Aggregates levy
Shared	VAT (assigned) Corporation tax (excl. North Sea oil) (assigned) Tobacco and alcohol duties (assigned)	VAT (assigned) Fuel and betting duties (assigned) North Sea oil revenue (geographical share)
Reserved	Employees' NIC North Sea oil revenue Fuel and betting duties	Employees' NIC
Public expenditure funding model	75-85% devo/assigned 15-25% needs-based equalising grant, borrowing (current expenditure split)	75-85% devo/assigned 15-25% fiscal transfer, borrowing (increased responsibility for social protection expenditure)

6.90. The *stable maximum* represents the level of autonomy for which Scotland could push if there are concerns at the time of the negotiations regarding the adverse effects of: (1) revenue volatility on the sustainability of the Scottish public finances; (2) high devolution of borrowing powers on the riskiness of Scottish profligacy for the UK Government's finances; and (3) administrative complexity on the efficiency of institutional operation at both the Scottish and UK tiers of governance.

6.91. In practice, this would mean the reservation of North Sea oil revenue and fuel and betting duties to the UK tier, the assignment rather than full devolution of corporation tax, and the assignment rather than full

[254] Ibid., p.30.

devolution of alcohol and tobacco duties, with a needs-based grant to 'smooth' revenue flows into the Scottish Parliament's budget.

6.92. The devolutionary approach would remain the familiar form of 'variable geometry' or 'devo more', which would probably conflict with, or preclude, attempts to 'redo' regional policy from a nationwide perspective.

6.93. The *technical maximum* represents the level of autonomy for which it is legally and constitutionally possible for Scotland to push, given (predominantly international) constraints on the UK's internal governance structure, and if the concerns that hold under the stable maximum are considered insufficiently significant.

6.94. North Sea oil revenue and corporation tax are fully devolved, along with the appropriate borrowing powers needed to manage their potential future volatility. Tobacco and alcohol duties are devolved to match the devolution of the NHS and healthcare policy to Scotland. Fuel and betting duties are assigned on the basis of an *ad hoc* estimate according to either a demographic or geographical split (subject to negotiation).

6.95. The devolutionary approach would be a more fundamental, nationwide implementation of a federal model, in part to ensure that the Azores conditions are definitely met for some of the elements of fiscal devolution (especially corporation tax) included in the technical maximum. **It also assumes a greater extent of devolution of social protection expenditure, as suggested by the (now former) Secretary of State for Scotland, Michael Moore MP, from the current 25.4% level to something closer to the full devolution of welfare favoured in the Scottish Social Attitudes survey—here set at 75%, or £16.0bn at 2011-12 levels.**[255] The high degree of Scottish autonomy would also be reflected in a shift from a 'needs-based equalisation' to a 'fiscal transfer' model for the block grant as an alternative to the Barnett formula.[256]

6.96. In practice, the autonomy that can be expected for Scotland in the 'technical maximum' version of this scenario, in addition to the powers attained in Scenario 1, is:

- → Significant degree of *fiscal convergence and restraint* enforced by *retention of UK£* and current macroeconomic conditions;
- → *Tax harmonisation and fiscal prudence* mitigating autonomy with *EU membership* (through UK);
- → Likely operating range of *corporation tax*: 12.5-17%;
- → Likely operating range of *income tax*: equivalent to SRIT of 9-11p on top of (UK rate – 10p) calculation;
- → Likely *VAT* rate determined by formula: $VAT_{Scot}(\%) = VAT_{UK}(\%) - h_{EU} - r_{UK}$.

6.97. **It is, of course, important to emphasise that some components of these two forms of autonomy are likely to be more long-term prospects for devolution, as envisaged by the four Unionist proposals above—especially North Sea oil revenues and excise duties.** But the logic for the APPTG's two alternative models is not (as yet) to do with short- or long-term-ness of implementation, but rather with the *principle* of what Scotland *could eventually* end up in control of while still remaining part of the Union.

6.98. They are more designed to inform the nuances of the post-referendum negotiations, and determine how far the SNP-led Scottish Government could hope to push its bid for a future autonomy settlement *immediately after* the referendum result. **The APPTG notes that, in some respects, the negotiation outcome after a narrow 'No' will closely resemble a 'fast-track' version of the trajectory of devolution mentioned as being eventually likely to happen under an outright 'No' in Scenario 1.**

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[255] 'Moore: welfare budget could be devolved', *Herald*, 12 August 2013.
[256] Trench, *Funding Devo More*, pp.38-40; Scottish Government, *GERS 2011-12* (2013), p.53.

7. Scenario 3: From one Union into another — a narrow 'Yes' vote

7.1. The third scenario, a *narrow* 'Yes' vote, is defined as a referendum result where fewer than 60% of Scottish voters vote 'Yes', and more than 40% vote 'No'—in technical terms, a *simple majority* for 'Yes'. The nearest comparisons are the referendum over the first Scotland Act in 1979, where 'Yes' defeated 'No' by 51.62% to 48.38% (although the result was subsequently overturned), and the referendum over the institution of the Welsh Assembly in 1997, where 'Yes' edged out 'No' by a mere 50.3% to 49.7%.[257]

Effects on the Scottish autonomy debate

7.2. The basic effect of a weak endorsement of independence would be relatively straightforward: it would simply trigger the next 'stage' of the process of extricating Scotland from the Union. The 'Yes Scotland' campaign would see the result as nothing more or less than a full principled acceptance of the case the SNP have consistently made for independence all along, and a strengthening of the Scottish Government's mandate (from the 2011 Scottish elections) to negotiate the creation of an independent Scottish state.

7.3. Unlike with the reverse case under a narrow 'No' outcome, it is unlikely that the 'Better Together' campaign would be able to leverage the presence of a 'significant minority' of 'No' voters into a clear bargaining position for the UK Government, since the substantive constitutional question would have been decisively answered. At most, they would induce the SNP to exercise caution and restraint in their plans for what form independence should take, and how quickly the transition to it should be effected, and perhaps encourage greater cooperation between the governments to find a mutually satisfactory solution.

7.4. There are two parallel questions which must be answered in the case of a 'Yes' vote which do not obtain in the case of a 'No' result. (1) *What, from a fiscal perspective, constitutes the achievement of 'independent' status over and above 'devo max'?* This question concerns the functional 'leaps up' that make independence a distinct cut-off point from previous stages of devolution, or place it on a point further along the autonomy trajectory than any 'devo' settlement can ever attain. It touches on the Electoral Commission's observation that a concrete definition of 'independence' needs to be crystallised out from vague understandings of 'separateness' and 'self-organisation', asking whether there are forms of both of these which can only be achieved for Scotland by exiting the Union (see §0.14).

7.5. The other question approaches the same problem from the reverse angle. (2) *What aspects of full separation can be sacrificed, from a fiscal perspective, without resulting in the loss of 'independent' status?* This question addresses the practical restrictions on complete autonomy which can be imposed without rendering Scotland's constitutional exit from the Union functionally ineffective or a mere technicality. It is what is most obviously at stake in a 'cautious' SNP approach to the post-referendum negotiations, where they would have to weigh up the ideal of independence against the practical requirements of 'good governance', and potentially contain the former in order to give Scotland international politico-economic stability and credibility.

7.6. The basic premise, from a fiscal perspective, is that a 'Yes' vote of any form means that Scotland *must* become formally—i.e., *de jure*, constitutionally and infrastructurally—completely autonomous from the UK.[258] **It is abundantly clear that there could be no continuation of a block grant of any form (Barnett formula, need-based, or equalising) from Westminster to Holyrood, or of revenue assignment—even if there were the political will there to do so—as any such arrangement would conflict with EU state aid rules.**[259]

[257] Denis Balsom and Ian McAllister, 'The Scottish and Welsh devolution referenda of 1979: constitutional change and popular choice', *Parliamentary Affairs* 32:1 (1979), p.401; 'Welsh referendum analysis: Wales "united in clear vote"', *BBC News*, 4 March 2011.
[258] Scottish Government, *Fiscal Commission Working Group: First Report—Macroeconomic Framework* (2013), p.10.
[259] Mawdsley and Payne, *Interview*.

7.7. **The only acceptable continuation of the block grant or revenue assignment would be as a temporary measure during the transition period between a 'Yes' vote and the formal independence date, and even then there would be obvious incentives on both sides to taper off such an arrangement fairly swiftly.** Scotland would have to become fully fiscally self-responsible, which means that all the taxes *devolved* in Scenario 2 would still be transferred, and that the taxes *reserved* or *shared* under the two models of maximal autonomy outlined above would, in effect, have to be transferred as well.

7.8. The constraints imposed by the UK's EU membership on the possibility of devolving fuel duty and especially VAT would no longer apply; tobacco, alcohol, and betting duties would pass *de facto* into the Scottish Government's remit; a way would need to be found to arrange a division of the North Sea oil reserves; and the eventual (even if tapered) discontinuation of the 'social Union' (at least for Scotland) would remove the justification for reserving corporation tax and especially NICs. **The losses in stability or administrative difficulties which could justify reservation or sharing of certain fiscal powers under a 'No' vote would simply have to be taken on and dealt with.**[260] **At the same time, under a 'Yes' vote, Scotland would, of course, have the opportunity to amend the tax system in a way that reduces costs and burdens on Scottish taxpayers in a way unavailable to devolved regions in the RUK.**

7.9. The SNP Scottish Government have announced that it will publish a White Paper intended to outline the "substantive case for independence" in November 2013.[261] In the meantime, the most concrete indication of the 'Yes' campaign's economic 'guiding view' of an independent Scotland is given by the report on Scotland's macroeconomic framework from the Fiscal Commission set up by Scottish Government, released in February 2013. This report outlines the monetary, financial, and fiscal aspects of the Scottish Government's overarching constitutional conception of independence—a conception which the Devo Plus group have characterised as "indy lite", and which George Kerevan described as "confederation in all but name".[262]

7.10. From an economic perspective, the Scottish Government's most significant proposals have been the retention of a currency union with UK£ (which enjoys considerable support in the relevant surveys), and the intention to secure EU membership for Scotland—a pooling of economic sovereignty with London, and a pooling of political sovereignty with Brussels.[263] **The APPTG's analysis in this section this examines to what extent a 'Yes' vote in the referendum would *constitutionally* break apart the Union between Scotland and the RUK, but might leave Scotland "not so independent" at all in practice.**[264]

7.11. It is beyond the remit of this report to examine the relative merits and demerits of Scotland's various monetary and financial policy options beyond their points of overlap with, or salience for, fiscal policy. The main loci of analysis here are the potential fiscal constraints which either currency union or EU membership would impose on an independent Scotland, and the extent to which these constraints differ from those faced by Scotland as a subsidiary region within the UK.

Scotland's currency options

7.12. By *de facto* ceding control of monetary policy to the Bank of England, Scotland would become dependent on a central bank and lender of last resort on which it would have very little influence. The Fiscal Commission has proposed that the Scottish Government should have "formal input into [the] governance and remit (including key committees such as the MPC [Monetary Policy Committee]) of the BofE [Bank of England] as an explicit shareholder of the Bank".[265] Such input might include giving Scotland explicit representation through one 'Scottish' member of the MPC, which would approximately reflect (albeit with slight over-representation) of Scotland's population share of the putative 'sterling-zone'.

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[260] McLean, *Interview.*
[261] Scottish Government, *Your Scotland, Your Referendum* (2012), p.14.
[262] Devo Plus, *Stronger Scotland*, p.6; George Kerevan (Former Associate Editor, *The Scotsman*), *Interview*, 13 November 2012.
[263] Scottish Government, *Macroeconomic Framework*, pp.9, 11; Robbie Dinwoodie, 'Scots want to keep the pound', *Herald*, 9 May 2013.
[264] McCluskey, *Interview.*
[265] Scottish Government, *Macroeconomic Framework*, p.9.

7.13. However, even with such representation, it would still be possible for this member to be simply outvoted by the remaining MPC members—and it is inconceivable that the UK Government would agree to any form of Scottish veto over RUK monetary policy decisions.[266] **The APPTG is not convinced that a narrow 'Yes' vote would give the Scottish Government a strong enough hand to be confident of negotiating such an arrangement, leaving Scotland effectively dependent on the trajectory of RUK monetary policy.**

7.14. The UK Government has also expressed scepticism towards the possibility of becoming the *de facto* guarantor for the finances of a newly-independent Scotland—or rather, *remaining* the guarantor in a broadly comparable way to what has been the case for Scotland up to now within the Union:

> Were an independent Scottish state to look to the Bank of England to provide lender of last resort facilities, this would also need to be agreed by both the UK and Scottish governments. Questions around the governance and political accountability of the Bank of England would need to be resolved. But, even with constraints in place, the economic rationale for the UK to agree to enter a formal sterling union with a separate state is not clear.[267]

7.15. **The APPTG sees little prospect for the UK Government to be able to persuade RUK taxpayers that it is in their interest to formally stand behind Scottish financial institutions in any context where Scotland would be seen to have *rejected* membership of the Union with the RUK, and of the shared social and economic commitments that implies.**[268]

7.16. However, the heavy reciprocal integration of the Scottish and RUK economies *as well as* the shared denomination of Scottish and RUK government debt in UK£ would mean that the UK Government would *be forced to intervene anyway* if the Scottish Government developed either liquidity or solvency problems, as happened with the UK contribution to the international bailout package for Ireland in 2010 (despite its membership of the eurozone).[269] **The APPTG thus agrees with both HM Treasury and the House of Lords Economic Affairs Committee that some form of stringent agreement would be required between the Scottish and UK Governments that addresses the implications for the UK of Scotland's continued use of UK£.**[270]

7.17. The effect for Scotland would be that Westminster would demand tight constraints on fiscal policy, in the form of a formal "understanding on Scotland's fiscal balance".[271] This could be done either through the establishment of a system of Scottish budget balance rules, as recommended by the Fiscal Commission, or by the Scottish Government buying informally into the fiscal targets in operation in the UK.[272] **In either case, the APPTG believes that Scotland's fiscal policy would be restricted by remaining in a currency union with the RUK—and would not constitute "full fiscal autonomy" as suggested by the Fiscal Commission Working Group.**[273] Without room for policy manoeuvres, it becomes questionable how meaningful the economic sovereignty which Scotland would retain under this scenario would actually be.[274]

7.18. As shown by both the example of Ireland after independence from the UK, and the more recent experiences of the eurozone, the best operation of an optimal currency area requires an extensive degree of economic harmonisation and policy co-movement—which implies that an independent Scotland would exhibit a large degree of fiscal convergence with the RUK as long as it retained the use of UK£.[275]

7.19. The purpose of such fiscal integration measures would not be intended for the economic benefit of Scotland, but rather to assuage the concerns of the RUK. In order for independence with a currency union to be palatable for RUK voters, the UK Government would need to demonstrate the presence of clear mechanisms to keep Scotland 'manageable' and prevent it from being fiscally profligate and thereby becoming 'too big to fail' for the RUK.

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[266] Henderson, *Interview*; Teather, *Interview*, 16 October.
[267] HM Treasury, *Scotland analysis: Currency and monetary policy* (2013), p.8.
[268] House of Lords Economic Affairs Committee, *Economic Implications*, p.23; Sinton, *Interview*.
[269] 'Ireland bailout: UK to lend £7bn', *Guardian*, 22 November 2010.
[270] House of Lords Economic Affairs Committee, *Economic Implications*, p.48; Sinton, *Interview*.
[271] Sinton, *Interview*.
[272] McLean, *Interview*.
[273] Scottish Government, *Currency Choices for an Independent Scotland: Response to the Fiscal Commission Working Group* (2013), p.11.
[274] Taylor, *Interview*; Henderson, *Interview*; Miers, *Interview*.
[275] Teather, *Interview*, 16 October; McLean, *Interview*; Sinton, *Interview*.

7.20. The current Chancellor, Rt Hon George Osborne MP, has suggested that, if an agreement on were reached, Westminster would "expect to have more control over Holyrood than Germany [the dominant eurozone economy] has over its eurozone partners".[276] The result for Scotland would be, as for Ireland post-independence, that the price for stability in the currency markets would be Scotland's limited ability to use its newly-gained fiscal powers to drive Scottish growth and prosperity—one of the more 'hidden' ways in which the UK would retain control over a nominally independent Scotland.

7.21. **The APPTG notes that an independent Scotland would be likely to have to operate a tight fiscal policy initially *in any case*, in order to build up a reputation for fiscal prudence, and avoid downward pressure on its credit rating.**[277] Establishing a credible reputation of good financial management would, at least initially, outweigh the Scottish Government's focus on setting its own economic priorities or pursuing a new 'Scottish Way'. This is particularly true in the current economic climate, where Scotland would need to take on a share of the UK public-sector debt, including the bailouts of RBS and HBOS Lloyds, determined either as a demographic proportion or by geographic attribution of the activity that contributed to the debt. **The APPTG agrees with the House of Lords Economic Affairs Committee's recommendation of using a demographic measure to determine the allocation of debt, and notes its estimate that a demographically proportionate (8.4%) share would lie at around £93bn, or 61.6% of Scottish GDP.**[278]

7.22. **The APPTG thus believes that it would be relatively unproblematic for Scotland to keep the UK£ initially as a transitional measure, thereby also helping reduce the immediate costs of independence, in order to smooth a later transition to a 'more independent' status that included Scotland adopting its own separate currency, and with it, genuine economic sovereignty.** However, the Scottish Government has given no indication of wanting to 'float off' into a separate Scottish currency once Scotland's fiscal credibility has been established and confirmed—which means that there is no time-limitation for how long their tight fiscal policy would have to be maintained.

7.23. **The APPTG notes that the UK Government have expressed serious doubts even about the possibility of the RUK agreeing to a "euro-style currency zone" with Scotland at all.**[279] It would be theoretically possible for Scotland to unilaterally adopt the UK£, in the same way as Montenegro has the euro, or Panama the US$, in that the UK could not *prevent* Scotland from using UK£, but such an arrangement would make it extremely difficult for Scotland to reap the benefits of independence, especially if the UK Government were minded to use its effective veto over Scottish monetary policy as a tool in hostile Scotland-RUK economic competition.[280]

7.24. In particular, the lack of a credible financial regulator or a central bank able to take clear, rapid decisions over monetary policy would not be conducive to Scotland's ability to maintain confidence in its substantial financial services sector.[281] Overall, it is clear that this aspect of independence would be very much a matter for negotiation after a 'Yes' vote, but it is much less clear which side of the argument would be likely to eventually win out.

Scotland's membership of the EU

7.25. The consensus within the 'Yes' campaign that an independent Scotland should aim to stay, or become, an EU member state also has restrictive implications for the fiscal policy the Scottish Government could operate. The experiences of the eurozone, and a growing realisation of the tensions of maintaining a

[276] 'Scottish independence: Treasury says currency pact case "not clear"', *BBC News*, 23 April 2013.
[277] Chris Giles, 'Doubt cast on any future Scottish sovereign rating', *Financial Times*, 5 February 2012; Douglas Fraser, 'Scottish independence: credit where it's due', *BBC News*, 19 October 2012; 'An independent Scotland would struggle with its credit rating', *Herald*, 25 February 2013; Simon Johnson, 'SNP "has no plans to research separate Scotland's credit rating"', *Telegraph*, 30 May 2013; Andrew Whitaker, 'Independent Scotland credit equal to Switzerland', *Scotsman*, 17 July 2013.
[278] House of Lords Economic Affairs Committee, *Economic Implications*, pp.16, 27.
[279] 'Scottish independence: Treasury says currency pact case "not clear"', *BBC News*, 23 April 2013.
[280] Henderson, *Interview*.
[281] Sinton, *Interview*.

common market and political union, and also rivalrous inter-state fiscal competition, has made the prospect of tax harmonisation inside the EU increasingly likely.

7.26. The harmonisation of energy taxation and its implications for fuel duty have been seen in Scenario 2 (see §6.62), and the current proposals for a Europe-wide financial transactions tax are evidence of a steady trend towards fiscal coordination between EU member states.[282] The result for Scotland would be that the move towards fiscal convergence in the EU might see its newly-attained political sovereignty slightly encroached on by more assertive EU institutions.[283]

7.27. Regardless of whether Scotland would be able to inherit EU member status from the UK as a 'successor state', or whether it would be forced to reapply for EU membership, it would have to address the question of whether to join the euro, which is currently a condition of EU membership. **While in theory it is likely that Scotland would have to formally negotiate its own opt-out from the euro, as the UK and Denmark have done, the APPTG does not consider it likely in practice that the EU would exert much pressure on Scotland to join the euro, given the parlous state of the eurozone.**

7.28. Poland, Sweden, and the Czech Republic are all committed to *eventually* joining the euro in theory, but have put the process of actually doing so on hold indefinitely for obvious macroeconomic reasons—an *ad hoc* arrangement which Scotland should be able to imitate without difficulty.[284] **The APPTG observes that this outcome is made even more likely by the fact that the major eurozone economies would impose "super-Maastricht" conditions of fiscal prudence on any state wishing to join the single currency, including strictures around their fiscal balance which would prove too stringent for Scotland in the short-term.**[285]

7.29. **The APPTG suggests that negotiating a retention of EU membership would effectively lead to Scotland moving from being a constituent unit in one Union (the UK) to the same position in another (the EU). However, the APPTG observes that such an arrangement may provide a better satisfaction of the stated Scottish popular preference for "giving the Scottish Parliament responsibility for everything apart from defence and foreign affairs"—i.e., exclusive responsibility for fiscal policy** (see §§4.5-8).[286]

7.30. The EU is proactively evolving in a direction that includes the formulation of a common foreign and defence policy, as part of a wider project of transforming the EU into a more cohesive, streamlined political entity.[287] In other words, the EU is developing the capacity to exercise precisely those functions which Scottish voters are prepared to leave to a *higher* tier of governance than Holyrood—that of a minimal 'diplomatic Union', rather than the thicker 'social Union' of the UK.

7.31. While there are certainly harmonisation constraints on fiscal policy, policy control remains by and large with individual member states in a way that would not be stably possible under only devolved autonomy within the UK, as shown in Scenario 2 (see §6.95-6). **The APPTG thus observes that independence combined with EU membership may be a more accurate reflection of the popular conception of 'devo max' than any model of 'devo more' compatible with remaining in the Union with the UK.**

7.32. **The APPTG also notes that there is a possibility in the medium-term that independence may be the only constitutional relationship relative to the UK under which Scotland's membership of the EU is *guaranteed.*** There is growing political will in Westminster for a re-evaluation of the UK's relationship with the EU, either in the form of a renegotiation of the terms of the UK's membership, including a reassessment of the policy areas for which the UK opts into, or out of, EU rules, or a full referendum over the UK's membership.

7.33. The Prime Minister, Rt Hon David Cameron MP, has outlined a proposal to negotiate the "repatriation of a series of powers to Britain" in the case of a Conservative victory at the 2015 UK General Election, with a

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282 'Financial transactions tax in Europe given go-ahead', *BBC News*, 22 January 2013.
283 Miers, *Interview*.
284 Taylor, *Interview*; Miers, *Interview*; McLean, *Interview*.
285 McLean, *Interview*.
286 Curtice and Ormston, 'Attitudes towards Scotland's Constitutional Future', p.3.
287 Mawdsley and Payne, *Interview*.

referendum on the settlement held by the end of 2017.[288] Given that this would be three years after the Scottish independence referendum takes place, there is a danger that Scotland will have its choice over EU membership 'made for it' by the UK—leaving it unable to benefit from the advantages of EU membership *if it stays in the Union*, rather than *if it secedes*.[289]

7.34. **The APPTG thus observes that a narrow 'Yes' vote in the referendum in 2014 could, in fact, be more accurately described not as making Scotland *independent*, but as leaving it *doubly non-independent*—or, for ease of expression, *doubly dependent*.** First, by keeping the UK£, it would become dependent on the Bank of England as a central bank and lender of last resort, and on the UK Government's lead for its fiscal responsibility rules. Second, by becoming an EU member, Scotland would need to conform to the EU's rules on fiscal harmonisation, and may see its defence and foreign policy arrogated to the EU tier of governance in the long-term.[290]

Effects on Scotland's fiscal arrangements

7.35. These general constraints have quantifiable implications for the specific components of Scottish fiscal policy. **With *corporation tax*, the APPTG notes that the overwhelming majority of the questions and concerns raised under a narrow 'No' vote in Scenario 2 still apply in a recognisably familiar form under a narrow 'Yes' vote here** (see §§6.16-37). Although the UK Government can no longer withhold devolution of corporation tax, it may seek to extract an informal commitment from the Scottish Government not to compete aggressively on corporation tax—an approach backed by the same implicit threat as in Scenario 2 that the RUK would be able to 'weather' such competition more easily than Scotland (see §6.31).

7.36. Independence would also leave Scotland fully exposed to EU norms and *de facto* restrictions on the extent of corporation tax variation tolerated across EU member states.[291] At the same time, the continued need for Scotland to be *sufficiently different* to attract businesses from the RUK and elsewhere would require Scotland to plan for a similar rate cut as under 'devo more' for such a policy to have the desired effect (see §6.29).[292] The result is that the likely operating range of Scottish corporation tax will still be between 12.5% and 17%, which means that the Scottish Government will be *barely more* able to pursue its Scandinavian-inspired 'guiding view' of low corporation tax and high income tax under independence than it could under 'devo more' (see §§6.36-7).

7.37. The most significant effect of Scotland's EU membership would be that, under the EU Code of Conduct for business taxation, it would not be able to discriminate between different sectors of its economy in order to favour, or attract, businesses from a particular industry.[293] There is a parallel here with Ireland, which sought to operate a 2-tier corporation tax rate, of 10% for manufacturing and financial institutions and 32% for all other companies, in order to profit from a service-sector-led boom—a model which might, under other circumstances, appeal to a service economy such as Scotland.

7.38. Due to Ireland's membership of the EU, however, the Irish Government was forced to shift to a single overall rate of 12.5% in 2003.[294] **The APPTG thus observes that, while independence would certainly give the Scottish Government more direct freedom to set the corporation tax rate it wants (subject to entirely practical constrains), EU membership would require this to be universal across all sectors of the Scottish economy, and hence limit Scotland's sovereignty over business policy in the same way as that of other EU members states.**

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[288] 'David Cameron calls for UK exemption from EU's "ever-closer" union', *Guardian*, 23 January 2013.
[289] Willie Rennie, 'The fear in a continental drift', *Scotsman*, 5 June 2013.
[290] Eddie Barnes, 'SNP "not offering" full independence', *Scotsman*, 29 May 2013.
[291] Teather, *Interview*, 16 October; House of Lords Economic Affairs Committee, *Economic Implications*, Oral evidence—Prof John Kay (22 May 2012), Q93.
[292] Mills, *Interview*.
[293] Teather, *Interview*, 16 October.
[294] Irish Tax and Customs, '10% rate of Corporation Tax for Manufacturing Enterprises'.

7.39. In a similar vein, the questions of rate-variation, fiscal sustainability, tax avoidance, and sufficient difference that applied to *income tax* in Scenario 2 continue to hold under independence (see §§6.39-48). As with corporation tax, it is very likely that the UK Government would seek to persuade the Scottish Government of the merits of maintaining a "friendly neighbours" situation, both to avoid aggressive competition, and to preserve both states' financial stability and reputational credibility.[295]

7.40. It is not plausible that an independent Scotland would indulge wild variations in income tax, as the overall take must remain fairly stable, at least initially.[296] The reasons for this are exactly the same as for the limitation of variation in SRIT under Scenario 2: stability, sustainability, avoidance of political and legal retribution, and avoidance of tax flight (see §§6.44-46). **The APPTG thus believes that the margin of variation would be limited to ±1p adjustments at each rate level (assuming the starting-basic-higher-additional rate distinctions are retained) in practice. The income tax rate variation feasible under independence would hence be broadly equivalent to a 9-11p variation in the SRIT under a full implementation of the Scotland Act 2012.**

7.41. The greatest freedom Scotland would enjoy with income tax would be the manipulation of income tax bands to make the overall structure more progressive, and to pursue its model of social democracy. **However, the APPTG notes that such amendments would be possible *in principle* under 'devo more' as well, since the administrative complexities of doing so would be exactly the same, with the only difference being the absence of the moral concern for preserving the 'social Union' under full independence** (see §6.47).

7.42. The effect of a 'Yes' vote on *NICs* stems largely from the discontinuation of the 'social Union' they are designed to symbolise and support in the UK tax system (see §6.52). There would no longer be a need to ensure parity of treatment between Scottish and RUK citizens as fellow citizens of the UK, but a certain degree of reciprocity of social rights would be ensured by both Scotland's and the UK's membership of agreements and treaties such as the European Social Charter, or at the very least through a separate Scotland-RUK agreement.

7.43. In practice, the *de facto* transfer of employers' *and* employees' NICs to Scottish control would give the Scottish Government a considerable degree of leeway it would not enjoy under 'devo more' to develop innovative approaches to reforming or replacing the national insurance system, or merging the functions of NICs into existing income and business taxation. As a short-term measure, the Scottish Government would have the leeway to lower employers' and/or employees' NICs by 1-3% in order to attract corporates and high-income taxpayers without disturbing the stability of the overall tax revenue too far.[297] **Since there are no conditions associated with EU membership that would prevent such reform, the APPTG notes that this would be one of the main 'steps up' from 'devo more' conceptions of autonomy, and a distinctive result of a 'Yes' outcome in the 2014 referendum.**

7.44. The possibilities for *VAT* are another of the major incommensurabilities of 'devo more' and independence. **The APPTG notes that a 'Yes' vote is the only way that Scotland would gain control of VAT from the UK, due to the stipulation of geographical VAT uniformity across each member state under EU rules. However, the APPTG also argues that this additional aspect of direct fiscal responsibility does not extend Scottish control over the structure or application of VAT very far.** As an EU member state, Scotland *must* have VAT, and its chosen rate *must* lie above the 15% minimum stipulated by the EU—and could in practice not extend far above 25%, which is the *de facto* upper bound in operation for most EU member states.

7.45. Further, the goods and services eligible for a reduced rate of VAT, typically no less than 5%, are restricted to a set list laid out by the EU VAT Directive: these include basic foodstuffs, books, historical and cultural services, the housing sector, catering, and labour-intensive locally-supplied services.[298] As a result, Scotland

[295] Mills, *Interview*.
[296] Sinton, *Interview*; Mills, *Interview*.
[297] Peter Hopkins (Director of Universal Credit, Department of Work and Pensions), *Interview*, 13 August 2012.
[298] European Commission, *VAT Rates Applied in the Member States of the European Union* (2013), pp.4-8.

need no longer match the UK's VAT rates, but would have limited scope to compete with the RUK or any other EU members in terms of the goods and services included in the VAT tax base.

7.46. Moreover, the Scottish Government would be unable to innovate to replace VAT with an alternative form of consumption tax if VAT proved in some way inadequate, such as the localised sales taxes levied by US states, and would thus be forced to align its 'guiding view' of the Scottish tax regime to the prevalent harmonised practices in the EU.[299]

7.47. The historically highest-profile aspect of Scottish independence has, of course, been the allocation to Scotland of the revenue from 'its' *North Sea oil* reserves. Since the block grant would no longer apply in the case of independence, Scotland would be exposed to the full potential volatility of future US$ oil prices and the UK£ exchange rate, just as under equivalent devolution in Scenario 2 (see §6.58). This may require Scotland to make more proactive use of its new *de facto* borrowing powers than the UK Government might be comfortable with, or than the need to build a reputation for prudent financial management on the global markets would ideally permit.

7.48. Unlike under 'devo more', Scotland's borrowing powers could not be simply revoked by the UK Government (see §6.75), while the denomination of Scottish debt in UK£ would mean that the UK Government would *still* be forced to deal with the effects of Scottish profligacy, including likely adverse implications for the RUK's credit rating and borrowing costs. **The APPTG thus observes that oil price volatility combined with a currency union between Scotland and the RUK may result in protracted, acrimonious conflict between them over fiscal policy, with their shared monetary policy as the mechanism by which their economic fortunes are shackled together, and the source of the punitive tools with which such conflict would be acted out.**

7.49. With a 'Yes' vote to independence, the legal obstacles to transfer of control of *excise duties* to Scotland would, in effect, be removed. The main concerns here would be administrative, namely finding a way of dividing the current UK revenue from these duties into discrete Scottish and RUK geographical jurisdictions, and to a certain extent the duties' calculation and levying, both of which could be avoided under 'devo more' (see §§6.59-62). The problems of high mobility, competition, and avoidance would continue to apply, and it is likely that Scotland and the RUK would need to negotiate some form of agreement—at least on a temporary, transitional basis—to maintain a common framework for addressing these policy areas across the British Isles.

7.50. This is less of a danger with fuel duty than with betting and gaming duties, due to the EU's identification of fuel duty as a candidate for tax harmonisation (see §3.75). **However, the APPTG notes that a major advantage of independence would be Scotland's ability to instigate substantial reform of how these duties are levied and calculated in a way that would only be possible through inter-regional agreement at a UK-wide level under 'devo more'.**

7.51. In general, the main aspect of taxation reserved to the UK tier under 'devo more' which would *de facto* come under Scotland's control under independence is the definition of *tax bases*, on top of the tax *rates*, *allowances/discounts*, and even *bands* which could (in principle) be transferred to Scottish control under 'devo more' (see §6.70). This would give Scotland the ability to set different rules on, for example, expenses, definitions of income, the goods and services exempted from VAT, and the goods and services on which excise duties are levied—in other words, to create a distinct Scottish 'view' of what constitutes 'good' and 'bad' expenditure.[300]

7.52. However, EU membership imposes a few clear restrictions on the extent to which Scotland could innovate in this aspect of taxation. The European Commission is in the process of consolidating the rules in place for some of the major sources of government revenue, including the rules for taxation of savings income (in the form of interest payments), and the proposal for a Common Consolidated Corporate Tax Base.[301]

7.53. Moreover, the existence of a common market between EU member states means that Scotland could not broaden the tax base for its most lucrative revenue sources too far without running the risk of losing the

[299] Teather, *Interview*, 16 October.
[300] McLean, *Interview*.
[301] European Union, Council Directive 2003/48/EC; Proposal for a Council Directive COM/2011/121.

income from its most mobile personal and corporate taxpayers**. Nevertheless, the APPTG suggests that, just as with the definition of tax *bands* under 'devo more', the control over tax *bases* available under independence constitutes a vital tool which the Scottish Government could use to shape the progressivity and overarching 'guiding view' of its tax regime.** This has already been applied on a small scale to the LBTT and Landfill Tax, but could be exercised to great effect with respect to the Scottish Government's other sources of revenue.

Constitutional implications

7.54. **The APPTG notes that the 'deeper' constitutional question of finding an arrangement between the Scottish and RUK polity is significantly easier in the case of a 'Yes' vote than with a narrow 'No' vote.** As formal legislative competences would be fully devolved from Westminster to Holyrood under this scenario, there would no longer be a need for Scotland to participate in any UK-wide Constitutional Convention to weigh up the merits of devolution and federalism.

7.55. However, it is likely that a vote for Scottish independence would result in increased pressure from the other empowered regions for at least a relative, if not plausibly equivalent, increase in their autonomy from the UK tier. As an EU member state and participant in the UK£ currency union, Scotland would exist in *de facto* confederation with other European states (EU and EFTA members), and doubly so with the UK within the 'sterling zone'.

Conclusion

7.56. The APPTG refers to the substantive implications of this result as *concessive independence*. In summary, the further autonomy that can be expected for Scotland in this scenario, in addition to the powers attained in Scenarios 1 and 2, is:

- → Full *constitutional separation* from RUK governance and legal institutions;
- → Discontinuation (beyond transition) of the *block grant* from Westminster to Holyrood;
- → Responsibility for, and control over, all taxes *fully transferred* to the Scottish Government;
- → *Double non-independence* as a result of *retention of UK£ and EU membership*, though latter (possibly) only guaranteed by leaving the UK;
- → Significant degree of *fiscal convergence and restraint* enforced by (possible) retention of UK£ and current macroeconomic conditions, without foreseeable end-point;
- → *Tax harmonisation and fiscal prudence*, though not necessarily adoption of the euro, mitigating autonomy under effective popular conception of 'devo max' with EU membership;
- → Likely operating range of *corporation tax*: 12.5-17%;
- → Likely operating range of *income tax*: ±1% at each income tax rate level;
- → Ability to lower rate for *NICs* by 1-3% relative to current level;
- → *VAT* required by EU membership, likely rate in range of 15-25%.

8. Scenario 4: 'A skiff made of tartan' — an outright 'Yes' vote

8.1. The fourth and final scenario, an *outright* 'Yes' vote, is defined as a referendum result where more than 60% of Scottish voters vote 'Yes', and fewer than 40% vote 'No'—in technical terms, a *supermajority* for 'Yes'. The more recent referenda in the devolved regions make for the best parallels here, including the referendum on extending the law-making powers of the Welsh Assembly in 2011, where 'Yes' defeated 'No' by 63.49% to 36.51%, or the two-question referendum which instituted devolution to Scotland in 1997, where on the establishment of the Scottish Parliament 'Yes' defeated 'No' by 74.3% to 25.7%, and on giving the Parliament tax-varying powers 'Yes' defeated 'No' by 63.5% to 36.5%.[302]

Effects on the Scottish autonomy debate

8.2. The basic effect of a strong endorsement of independence would—as for the weaker variant—be the move to the next 'stage' of the process of making Scotland independent. The main difference would be in the comparatively more assured approach of the pro-independence negotiators, in that a strong result for 'Yes' would be seen to give the concept of separation and self-organisation clear democratic consent and popular legitimacy.

8.3. From a strategic perspective, the SNP-led Scottish Government would be in an even stronger bargaining position than after its election victory in 2011, as it would have the mandate to pursue a considerably more ambitious independence programme than it would initially have expected to secure. With a result that leaves 'No' voters clearly in the minority, the terms negotiated would effectively be dictated by the confidence of the 'Yes' campaign in deciding an international political economy for the nascent Scottish state that could be altogether more daring and assertive relative to their negotiating partners in both the RUK and the EU (and the relevant other international institutions).

8.4. Any vision of an independent Scotland that goes beyond the case put forward by the SNP-led Scottish Government is, by definition, a more radical view of *unthirldom* than any that is being considered in the autonomy debate at this time. **The APPTG notes public speculation that this is due to an implicit commitment by the SNP leadership to characterising independence as a genre of 'devo max', as the best way to sell independence to the Scottish electorate.**[303] **The APPTG takes no position on such speculation beyond suggesting that it demonstrates the need for full and equal public consideration of all the options available to Scotland after the 2014 referendum.**

8.5. **The APPTG has also heard views which suggest that an outright 'Yes' vote would allow Scotland to attain 'the only form of independence worth going for'—one that is less constrained by the retention of the residual links to the UK, and potentially the EU.** This scenario thus addresses the possibilities for Scotland if independence is given a bigger endorsement than the 'Yes Scotland' campaign anticipates.

8.6. There are, again, two parallel questions under such a result, which echo the questions under narrow 'Yes'. (1) *How much more radical, from a fiscal perspective, could Scotland be?* This question addresses what there is left separating the SNP's view of independence from what the Devo Plus group refer to as "full indy"—a complete separation of Scottish from UK institutions.[304] Essentially, the analysis here is over how much of what the SNP case for independence sacrificed under the narrow 'Yes' result could be retained for Scotland to control itself under the stronger referendum result.

8.7. The second question likewise approaches the point from the opposite angle. (2) *What limitations, from a fiscal perspective, does political and economic interdependence impose on 'full' independence?* This question takes a macroeconomic perspective from well beyond the UK level, and assesses whether there are certain practical

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[302] 'Wales says Yes in referendum vote', *BBC News*, 4 March 2011; 'Scottish Referendum Live—The Results', *BBC News*, 11 September 1997.
[303] Patrick Briône (Director of Research, Survation), *Interview*, 19 October 2012.
[304] Devo Plus, *Stronger Scotland*, p.6.

realities of international politics and economics which will mean that even a completely UK-independent Scotland would still have to give up *some* fiscal sovereignty. While this might not strictly be of concern during the Scotland-UK inter-governmental negotiations, it is a question that would need to be borne in mind as Scotland is taking its first steps to assert itself as a new player on the global stage.

Scotland's currency options

8.8. The central question in this scenario remains: what is the Scottish currency going to be?[305] **The APPTG suggests that a strong 'Yes' vote could give the Scottish Government the confidence to formally explore the possibility of adopting a separate currency—perhaps called the 'groat', as suggested by Prof John Kay, but here termed the 'Scot£'.**[306] The APPTG heard from both independentist and Unionist stakeholders unaffiliated to the official 'Yes Scotland' and 'Better Together' campaigns a common view that 'committed' nationalism on the part of Scotland would involve having the courage to move to a separate Scot£.[307]

8.9. This could, of course, not happen immediately, since this would involve the creation of a new Scottish central bank to act as monetary authority and lender of last resort.[308] Keeping the UK£ would thus be an "interim solution" or transitional measure, as suggested in Scenario 3, except with the difference that the Scottish Government would be working towards an explicit ambition to move to the Scot£ at a given time (see §7.17).

8.10. **To further smooth this transition, the APPTG believes that the best practical option for Scotland in this scenario would be to maintain a link between the UK£ and Scot£ for a time after a separate monetary authority, currency, and debt-issuance capacity is established.** This would require the Scot£ to be pegged to UK£ either at parity, or within a relatively narrow permitted exchange rate range, as suggested by the National Institute of Economic and Social Research.[309] It would be backed by Scotland buying UK gilts, to allow for macroeconomic differentials between Scotland and the RUK, to be determined in the post-referendum negotiations.

8.11. It would also require free mutual circulation of UK£ and Scot£, which could in principle be continued on a post-transitional basis with the UK£ as an effective 'reserve currency' for Scotland, as with the circulation of the euro in the Czech Republic, to reflect the close integration of the Scottish and RUK economies. Such an arrangement would allow the Scottish Government to accrue foreign currencies to underpin its credit rating and creditworthiness, while continuing to benefit vicariously from the stability of the RUK economy.[310] **The APPTG suggests that, given the ongoing crisis in the eurozone, it is unlikely that a similar currency link to the euro would be as advantageous in the current economic climate.**

8.12. The advantage of prolonging the monetary connections and *de facto* currency equivalence between Scotland and the RUK, albeit in a weaker form than the retention of UK£ proposed under Scenario 3, would be that both states would have be able to functionally maintain a degree of *ad hoc* system-sharing between the political and economic institutions that would ultimately require separation due to Scotland's new independent status.[311] This would especially help prevent the 'blurring' of monetary and fiscal policy between the two governments, and would reduce the possibility of arbitrage between the Scottish and RUK systems due to the practical difficulties associated with combining structural separation with *fully* disconnected currencies.

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[305] Sinton, *Interview*.
[306] Kay, *Interview*.
[307] Miers, *Interview*; Kerevan, *Interview*.
[308] Kerevan, *Interview*.
[309] National Institute of Economic and Social Research, *Scotland's Currency Options* (2013); 'Scottish independence: Academics urge new Scots currency', *BBC News*, 17 September 2013; Szu Ping Chan, 'Independent Scotland faces decade of austerity, NIESR warns', *Telegraph*, 17 September 2013.
[310] Kerevan, *Interview*.
[311] Teather, *Interview*, 9 October.

8.13. At the same time, having its own currency would allow Scotland to decouple from the UK much more cleanly in the case of an asymmetric macroeconomic crisis, as well as eventually 'floating off' into scheduled full monetary independence as soon as its central bank and creditworthiness are reliably established.[312]

8.14. The most significant effect of monetary independence on fiscal policy is largely that Scotland would be free of the 'hidden' UK controls and demands for fiscal restraint that held under Scenario 3 (see §§7.14-6). From an RUK perspective, if Scottish Government debt is not denominated in UK£, there is less risk that high (possible) levels of Scottish spending would lead to the devaluing of UK£ and downward pressure on the RUK's credit rating, so it would be less urgent for the RUK to demand Scottish fiscal constraint.

8.15. However, high issuance of Scottish debt denominated in Scot£ would still put pressure on any currency peg with UK£, exacerbated by interchangeable circulation, especially of Scot£ in the RUK.[313] **The APPTG suggests that a politically stable solution in such a case might be to limit the interchangeability of the two currencies to Scotland only, in order to mitigate the effects of Scottish monetary policy on the RUK. But the APPTG believes that this is an unlikely eventuality: as with Scenario 3, the Scottish Government would have strong incentives to operate a tight fiscal policy immediately after achieving independence, in order to build the credibility of Scotland's new institutions** (see §7.14).

8.16. In light of Scotland's taking on a demographic share of the UK's public debt, as well as the added volatility it would face after taking on a geographical share of North Sea oil as a significant proportion of its revenue, the international currency markets would put pressure on the Scottish Government to operate close to a balanced budget, at least for the immediate future. There would thus be a fortunate alignment between the short-term macroeconomic incentives of Scotland and the RUK, which makes the adoption of a separate currency a less radical step, and less different from the retention of UK£, in terms of its effect on Scotland's initial options for fiscal behaviour.[314]

Scotland's membership of the EU

8.17. The other main question is whether Scotland would gain substantively from loosening its link with continental (Western) Europe. In contrast to Scenario 3, an outright 'Yes' vote might give the SNP-led Scottish Government the confidence to be more assertive in its negotiations with the EU as well, either to contest the European Commission's insistence that EU membership is something for which Scotland would have to reapply (and which could therefore be delayed or vetoed), or to meaningfully exercise its autonomy over the precise degree of European institutional integration in which it wants Scotland to participate.

8.18. Membership of the EEA/EFTA *rather than* the EU might give Scotland the opportunity to benefit from the connection to the common European market, but also cultivate more independent-minded policy and diplomatic links to Scandinavia, to which the SNP have long aspired. **The APPTG suggests that such a 'reduced' arrangement towards Europe might satisfy the "purist", isolationist tendency within the SNP, which views Scotland's ideal role as closer to that of Switzerland, and which would require some form of placation after the recent reversal of the SNP's official opposition to an independent Scotland's membership of NATO.**[315]

8.19. **However, the APPTG notes that non-EU EEA membership would still reduce Scotland's autonomy in a range of policy areas (including environmental policy, social policy, and company law), as well as possibly committing Scotland to an increasing degree of EU-like fiscal harmonisation, while preventing it from having meaningful input into the formulation of these policies through representation in EU institutions. The APPTG is thus unconvinced that Scotland would be able to avoid a 'ratchet effect', whereby 'reduced' *de jure* integration into European institutions nonetheless evolves to the stage where it *de facto* approximates a similar degree of integration as that which Scotland would face as a full EU member.**

[312] Kerevan, *Interview*.
[313] Teather, *Interview*, 16 October.
[314] McLean, *Interview*.
[315] Miers, *Interview*.

8.20. **The APPTG notes that *technically*, "full indy" as articulated by the Devo Plus group should entail Scotland literally 'going it alone' in the proper sense of the phrase.** This would, of course, be the *de facto* legal and constitutional situation in which Scotland would be initially, in between the formal declaration of independence in April 2016 and the formal enactment of negotiated entry into any other supranational political-economic association of sovereign states.

8.21. **However, the APPTG is not convinced that this is a plausibly sustainable situation for Scotland long-term.** With 45% of Scottish exports going to EU countries, and a further 10% to the rest of Europe, it would evidently be in Scotland's interests to maintain at least a trade bloc relationship with Europe, making EEA membership effectively a *minimum requirement* for an independent Scotland.[316]

8.22. Further, the slower growth and greater economic volatility which smaller states experience on average, relative to larger states, makes it likely that a small state like Scotland will need to forge links to, or join, a larger (often supranational) political-economic body in order to achieve long-term stability**. The APPTG suggests that, in this regard, EEA or EU membership would continue to be, as with Scenario 3, the best replacement for the Union with the RUK from Scotland's perspective.**

8.23. This raises the broader question of the degree of latent, or residual, international *interdependence* which would accompany even the most ambitious plans for Scottish independence in the case of an outright 'Yes' vote. It is clear that, even with complete independence, agreements will be needed with the RUK and EU to deal with the structures and resources Scotland shares with each of them out of sheer geographical proximity—including the effects of UK treaties and European agreements on common infrastructure and practices which Scotland would inherit from its former status within the Union.

8.24. From the fiscal perspective, Scottish independence would require the establishment of mechanisms that allow a discrete set of Scottish fiscal structures to exist in an interdependent way—essentially, copying or confirming mechanisms such as double-taxation agreements which Scotland currently benefits from as a constituent of the UK.[317] **The APPTG notes that there are thus legal limits on the extent to which Scotland could radically overhaul its internal fiscal composition.** Due to its close economic and political imbrication with the RUK and EU, Scotland would need to retain (even straightforward and rudimentary) points of commonality and reciprocal contact with its international partners in trade and diplomacy, in order to avoid distortion and disruption to its internal institutional arrangements.

Effects on Scotland's fiscal arrangements

8.25. The retention of greater economic and political sovereignty by Scotland through adopting the Scot£ and becoming an EEA member has some further implications for Scottish fiscal policy, beyond those outlined in Scenario 3 (see §§7.35-53). One of the more prominent would be its greater autonomy over *corporation tax*, since a strong 'Yes' result would make it more politically challenging for the UK Government to extract an informal commitment from the Scottish Government not to enter into aggressive tax competition.

8.26. At the same time, the EU would not be able to exert as much pressure and influence on Scotland not to lower its corporation tax rate below the Irish rate of 12.5%. **The APPTG thus believes that, subject to the affordability of the Scottish Government's spending plans, the lower bound of the likely operating range of Scottish corporation tax could fall below 12.5%, speculatively as far as 10%, in order to encourage corporates to relocate to Scotland.**[318]

8.27. Further, Scotland would not formally be bound by the EU Code of Conduct for business taxation, allowing it to vary corporation tax rates between different economic sectors to attract, for example, financial services or ICT and electronic technologies, as part of its comprehensive industrial policy.[319] **However, the APPTG notes that either drastically lowering or differentiating corporation tax rates would be incompatible with EU member status (normatively or legally), should a future Scottish Government aspire to this.**

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[316] Scottish Government, *Statistical Bulletin: Economy Series* (2013), p.6.
[317] Booth, *Interview*; Teather, *Interview*, 16 October; McLean, *Interview*.
[318] Hopkins, *Interview*; Taylor, *Interview*.
[319] Teather, *Interview*, 16 October.

8.28. It would also be a risky ploy for Scotland, as refusing to act as a 'friendly neighbour' to the RUK or EU in lieu of a formal union with either could trigger competitive retribution which Scotland would be in considerably worse position to afford than either of its rivals. As a result, Scotland is left to face a very discrete choice: exercise complete autonomy over business taxation, or profit from institutional cooperation and exercise input into EU directives on company law, which would apply to Scotland as an EEA member anyway.

8.29. Given that *income tax* would be extensively devolved under Scenario 2, and would be subject to at most practical financial restrictions under Scenario 3, there would be little to be gained for Scotland on this part of taxation through further institutional and monetary autonomy. The same concerns for stability and the need to construct an affordable social security system would still apply, and Scotland would already be able to amend income tax bands and thresholds to achieve its image of a progressive society.

8.30. The APPTG notes that there have been suggestions that EEA membership might enable Scotland to follow an aggressive income tax strategy that would enable it to become, in effect, a tax haven after the model of Liechtenstein or possibly Switzerland in the medium-term.[320] **However, the APPTG observes that there has been growing opposition within the EU to low-tax jurisdictions within Europe, and increasing concerted international efforts to put pressure on tax havens, which suggests that such a strategy would be impossible for Scotland to pursue without seriously jeopardising its relationship with its European partners.**

8.31. With regard to *NICs* under this scenario, since there are no conditions associated either with keeping UK£ or EU membership which impinge on their operation, the Scottish Government's policy autonomy in this area is exactly the same as under Scenario 3 (see §§7.42-3).

8.32. One of the clearest restrictions on Scotland that would be lifted under this scenario concerns the existence, and permissible range of rates, of *VAT* as the requisite form of consumption tax in Scotland. As a non-EU EEA member, Scotland would not have to abide by the 15% minimum rate stipulated by the EU, and could emulate Switzerland and Liechtenstein (both 8%) in levying a far lower rate. At the opposite end of the range, however, the *de facto* c.25% upper limit still holds for EEA states, with Norway (25%) and Iceland (25.5%) remaining careful not to make their tax régimes too uncompetitive—as well as too regressive—by setting too high a rate. Scotland would also no longer be dependent on derogations to be able to set a far greater range of differential rates, and zero-ratings, for certain goods and services.[321]

8.33. Further, as a non-EU member, it could hypothetically convert VAT into a local tax, administered wholly or partly by local authorities, although the APPTG does not see a convincing practical reason for devolution in this area below the Holyrood tier. In principle, Scotland could, in fact, replace VAT entirely with a national or local sales tax, as it would no longer be subject to the EU requirement of keeping VAT.[322]

8.34. However, the APPTG does not see this as a plausible use of Scotland's autonomy in this scenario, as VAT enjoys definite advantages of clarity and definition over a national sales tax, while the growth of online shopping has made the local operation of sales taxes somewhat redundant.[323] **Overall, the APPTG suggests that Scotland under this scenario would enjoy far greater leeway over setting its VAT rate, and by extension the progressivity of its consumer policy, than under any other autonomy scenario.**

8.35. The treatment of *North Sea oil* revenues under this scenario would, again, largely resemble the situation under Scenario 3: practical concerns of volatility might require Scotland to borrow proactively in order to smooth its revenue stream and give its public expenditure commitments long-term credibility and sustainability (see §§7.47-8). **The APPTG notes that this scenario might, in fact, see less conflict between Scotland and the RUK over Scotland's fiscal policy, as the denomination of Scottish debt in Scot£ would loosen the close imbrication of the two governments' creditworthiness under a currency union.**

8.36. Even with an exchange rate peg, this scenario would allow both Scotland and the RUK to respond more easily to market pressure on the UK£ link, either by altering the exchange rate at which the Scot£ is pegged

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320 Hopkins, *Interview*; Teather, *Interview*, 16 October.
321 Peter Seymour (Head of Government and Public Sector, VocaLink), *Interview*, 23 November 2012; Kay, *Interview*.
322 Whiting, *Interview*, 9 October.
323 Denham, *Interview*.

to the UK£, or by simply removing the peg and allowing the Scot £ to float for as long as Scotland's high borrowing requirements persisted. **The APPTG thus suggests that this scenario might even be preferable to Scenario 3 from the RUK's perspective, assuming that the referendum results in a 'Yes' vote, on the basis that it would remove the residual part-responsibility of the RUK for Scottish economic policy via the UK£ currency union.** In the words of Tom Miers, Scotland would be able, and required, to take full responsibility for "whole way" independence, rather than the "cheated fair-weather" independence offered under Scenario 3.[324]

8.37. Scotland's policy control in the area of *excise duties* under this scenario would also be subject to many of the same constraints as under Scenario 3, especially regarding the administrative problems of dividing the Scottish and RUK jurisdictions, and the need to negotiate some form of agreement to form a common framework with the RUK to address geographical mobility, competition, and avoidance issues (see §§7.49-50).

8.38. The main further source of autonomy would be that, as a non-EU member, Scotland would be less obliged to conform to EU plans to harmonise fuel duty. **However, the APPTG observes that, in light of international efforts and treaties to formulate a common global environmental policy, a similar effect would probably ultimately be achieved through multilateral agreements anyway, rendering the advantage of 'reduced' European integration for Scotland somewhat marginal in this area.**

8.39. The same relative freedom from EU harmonisation policies also affects the more general aspect of fiscal policy, the definition of *tax bases*. Scotland's highly valuable ability to innovatively vary these definitions would already be comprehensively established under a Scenario 3 form of independence, with the only restrictions on this being the proposed consolidations of rules on savings income and the corporate tax base (see §§7.51-2).

8.40. **In practice, however, the APPTG finds it likely that these consolidated rules will apply across the entire EEA, in order to alleviate concerns over tax arbitrage by mobile taxpayers within the common market.** As an EEA member, Scotland would thus be subjected to the same restrictions as if it were an EU member, except (again) without the ability to exercise institutional input into these restrictions' formulation.

Conclusion

8.41. The APPTG refers to the substantive implications of this result as *aspirational independence*. In summary, the further autonomy that can be expected for Scotland in this scenario, in addition to the powers attained in the three previous scenarios, is:

- → *Constrained independence* as a result of *temporary retention of UK£* until floating-off of Scot£ and *EEA membership*, as complete 'going it alone' is unsustainable long-term;
- → Significant degree of *fiscal convergence and restraint* enforced by transitional retention of UK£ and current macroeconomic conditions, with end-point fixed at when Scot£ floats off;
- → *Tax harmonisation* mitigating autonomy with EEA membership, due to 'ratchet effect' of *de facto* approximation of EEA member policy to *de jure* integrated EU members;
- → Likely operating range of *corporation tax*: 10-17%;
- → Likely operating range of *income tax*: ±1% at each income tax rate level;
- → Ability to lower rate for *NICs* by 1-3% relative to current level;
- → *VAT* not required but still best sales tax option, likely rate in range of 8-25%.

[324] Taylor, *Interview*.

9. The impact of the referendum

9.1. The four post-referendum scenarios have important implications for the future development of Scotland's fiscal policy. In particular, the practical context in which Scottish policymakers will need to formulate their vision of Scotland's political economy, as well as the climate of public opinion revealed in the referendum and during the negotiations afterwards, will shape both the level of autonomy Scotland is granted, and the fiscal policy flexibility Scottish Ministers will ultimately enjoy. This chapter explores the assessment that, while various possible outcomes for Scotland lie on a *continuum* between the *status quo* and full independence, they are *de facto* very likely to exhibit a strong degree of *convergence* towards a midpoint between the two positions.

Scotland's autonomy trajectory — the 'continuum thesis'

9.2. **The distinction between the outcomes of 'Yes' and 'No' in the independence referendum is not as discrete as the debate so far has made it seem.** The nuances within both a 'Yes' and a 'No' result to the independence vote that create the *scope for divergent interpretations and practical outcomes*, and hence the *need for negotiations*, lie between 'total' Unionism and 'total' independence. In reality, neither of these extremes are seriously represented in the current debate, and the emerging visions of both the 'Yes Scotland' and 'Better Together' campaigns combine elements of Unionism and independence—of homogeneity or integration, and difference or separation—in their 'offers' to Scottish voters. The 'Yes' camp's acceptance of the principle of a currency union between Scotland and England, and the 'No' camp's preparedness to countenance a more devolved settlement for Scotland are perhaps the clearest demonstration of this.

9.3. The 'Yes' and 'No' scenarios outlined above represent a steady, incremental progression in the calling-into-question of aspects of Scotland's current constitutional settlement from a fiscal perspective. There is nothing *as such* preventing the consecutive developments in this progression forming a 'sliding scale' from the *status quo* via 'devo max' to independence, given time and favourable circumstances.[325] **The APPTG terms this the *continuum thesis*—the view that any further movements to increase Scotland's autonomy from the UK lie on a (potential) trajectory that terminates in (some form of) independence.** The only requirements needed for *additional* shifts along this trajectory are: (1) the political will to do so; and (2) the assurance that the pace and magnitude of any such shift are politically and financially manageable for both Scotland and the UK.

9.4. For any such shifts to take place, however, it is vital to know the specific order in which things are, or should be, called into question. Since, as witnessed by historical cases of federalisation and secession elsewhere, the most fundamental governance functions are typically delayed till later on in the process of separation, taxation is likely to be one of the "last thing[s] to be devolved".[326]

9.5. The trajectory along the fiscal autonomy continuum involves steadily moving the Scottish and RUK tax systems further apart, starting with a joint system with independent elements, such as separate tax rates, and potentially leading onto later divergence into multiple independent tax systems.[327] What is clear is that, as with devolution so far, fiscal policy must continue to be devolved "tax by tax, not spending area by spending area"—and that such tax-by-tax negotiation will be much easier with a *roadmap for fiscal autonomy*.[328] **The APPTG will expand on this analysis to formulate such an explicit roadmap in a future report.**

9.6. At this point, however, it is important to bear in mind the caveat from the Calman Commission regarding the incompatibility of full fiscal autonomy with the maintenance of the Union—that the "various possible stages of devolution … are not as fluid, gradualist, or equilibrated in practice as in theory" (§2.13). **The**

[325] Mawdsley and Payne, *Interview*.
[326] Mawdsley and Payne, *Interview*; Teather, *Interview*, 9 October.
[327] Teather, *Interview*, 9 October.
[328] McLean, *Interview*; Teather, *Interview*, 9 October.

APPTG fully accepts that the constitutional relationship between the UK's constituent parts will be very different in the fiscal arrangement under Scenario 1 from that in effect now, or that under Scenario 2—let alone under the two independence scenarios.

9.7. Each result will require extensive consideration of the wider ramifications for the internal make-up and constitutional integrity of the UK polity—consideration which is vital for the debate, but lies beyond the remit of this report. In effect, the four scenarios outlined above constitute four possible halting-points on a UK-wide continuum between 'total' Unionism and 'total' mutual independence, narrowed to focus only on the politically 'imaginable' trajectory between the *status quo* and independence for the asymmetric case of Scotland.

9.8. Because of the hybridity of the 'Yes' and 'No' offers, the referendum outcomes associated with each of them lie significantly *closer* in substantive terms, and in terms of their practical implications, than either campaign might admit. While their substantive similarities are explored later in this chapter, the most significant illustration of this closeness comes with the observation that both outcomes can, and must, show extensive continuity with the arrangements made for Scotland by previous tranches of devolution. This is as much a question of legitimacy as of expedience: it *makes sense* to build on the developments that have taken place in Scottish autonomy so far, as they are what Scottish residents, businesses, and communities have started to become accustomed to.

9.9. For example, several of the major structural shifts that would be required for any transition to independence—specifically, from the fiscal angle—have already taken place for the comparatively slight shift to devolution so far. Apart from the obvious creation of executive, legislative, and bureaucratic institutions (the complexes at Holyrood, St. Andrew's House, Victoria Quay, and elsewhere), the processes for setting up a separate tax administration (i.e., Revenue Scotland) and creating a functional definition of 'Scottishness' as distinct from 'Britishness' are already in progress or partly complete. While these are obviously not the only changes that would be necessary, they are key prerequisites to future stages of both more advanced devolution, and independence, which now only require supplementary, or marginal, substantive adjustments.

9.10. **The APPTG thus believes that the innovations mandated by the 1998 and 2012 Scotland Acts should be seen as fitting easily into an approach which sees devolution and independence as different stages in an incremental development, and not a series of disconnected constitutional leaps.** This is not to take a stance on the putative division within the SNP between 'gradualists', who see devolution as a series of '*stepping stones*' *leading to* the ultimate goal of independence, and 'fundamentalists', who regard devolution as an unwelcome alternative that *prorogues the autonomy debate before* independence is achieved.

9.11. Rather, the implication is that the 'progress' of devolution could be halted at any stable point on the continuum (the 1998 Act, the 2012 Act, 'devo max', independence, &c) for as long as desired, without this providing any obvious reason for, or against, subsequent continuation of a straightforward decentralising trajectory. After all, this has been the *de facto* development of Scottish autonomy until now—a development which all sides in the debate have accepted as a broad success.

9.12. In this light, the question which analyses of Scotland's relationship with the UK need to answer is what such an incremental development would look like. **It is the APPTG's view that the answer to this question will be the same regardless of where devolution is ultimately halted.** In other words, the practical steps that would need to be taken for a transition from the *status quo* to *independence* would, certainly in their initial stages, be the same as those for a transition to (for example) *devo max*. This is not necessarily an intuitive assessment, and will be explored in further detail in a future APPTG report.

9.13. Specifically, the concern that this question addresses is whether there are any constraints on how the *process* of 'ratcheting-up' autonomy from stage to stage must take place. In a practical sense, a dedicated engagement is needed with 'what has to come first', in terms of the prerequisites for each element of control or responsibility to be transferred from Westminster to Holyrood, and the further opportunities for transfer each element enables.

9.14. This requires a clear assessment of: (1) which elements (powers, competences, mechanisms, institutions, &c) are already present in Scotland, or at a more advanced stage of devolution from the UK tier; (2) what order of precedence the elements still reserved to Westminster must take if they are to be devolved as well; (3)

what changes each 'type' of devolution settlement, or each referendum outcome, would bring about in the practical activity of individuals, businesses, and communities in Scotland, relative to how they have behaved so far as part of the UK.

9.15. The same will apply to the degree of *structural separation* which Scotland undertakes, either as an independent nation or as part of the UK.[329] Meaningful fiscal independence, as highlighted earlier in the report, requires not just *tax-setting* powers, but also extensive *tax-gathering* powers.[330] A balance thus needs to be struck between the inevitable requirement of Scottish public oversight over the body and infrastructure by which tax collection is administered, and the high costs that would be incurred through the introduction of a system separate from the existing UK arrangements.[331]

9.16. Given the effect this will have on taxpayers with over-the-border activity, the balance between control and cost can only be established through extensive negotiation. **This is another reason why the APPTG believes that discussion between the UK and Scottish Governments should not be delayed until after the referendum.**

9.17. It is important to note that questions of structural separation and residual coordination will apply regardless of whether the post-referendum outcome is independence or merely further devolution. It would be possible in principle for Scotland to retain joint provision of services with the RUK, both for fiscal infrastructure and in other areas of policy, such as defence or diplomatic engagement.[332]

9.18. The primary difference between independence and devolution would be that devolution allows a formalised internal "system" to stay in place to manage such pooling of political functions, while independence would limit this to *ad hoc* arrangements agreed via inter-governmental negotiations.[333] In both cases, however, the solution would presumably be one of Scotland paying a fee for the UK (or another body) to administer its non-devolved services—much like the EU's reliance on contributions linked to member states' Gross National Income and direct levies on VAT (arbitrarily dependent on the tax take) for its revenue.

Scotland's fiscal freedom — the 'convergence thesis'

9.19. The *principle* underpinning the continuum thesis is mitigated in *practice* by tensions within, and constraints external to, each of the four post-referendum scenarios. When considered tax by tax, the differences between the scenarios in terms of their effect on Scotland's fiscal situation are not as stark as the conceptual distinction between 'devo more' and independence implies. Scotland's continued close proximity to the RUK economy under all four outcomes and (likely) retained membership of the EU in all cases except (possibly) Scenario 4 impose clear limits and insuperable factors for consideration for any future Scottish Government, which mean that the marginal benefit of constitutional independence is not much greater than the maximum possible extent of fiscal devolution compatible with the retention of (some form of) the Union.

9.20. The result is that both the probable outcome in the referendum vote itself, and the settlement that emerges from the subsequent negotiations, will indicate a constitutional and fiscal arrangement located within a fairly narrow set of points along the continuum described above. **The APPTG terms this the *convergence thesis*—the view that the actual manifestations of the four scenarios will approximate towards a (relatively) predictable midpoint, regardless of Scotland's nominal constitutional status, given the conditions in which a more autonomous Scotland would have to operate.**

9.21. In part, this is because of the limited number of substantial transfers required to bring Scotland to a level of autonomy effectively equivalent to independence. Such a level of autonomy is achieved by: (1) entrenching certain degrees of sovereignty within the Scottish Parliament in certain policy areas; (2) granting the Scottish Government borrowing powers to enable it to run an effective autonomous regional policy; (3) giving

[329] Seymour, *Interview*.
[330] Booth, *Interview*.
[331] Teather, *Interview*, 9 October.
[332] Booth, *Interview*.
[333] Teather, *Interview*, 9 October.

Scotland a significant degree of decentralised responsibility for business taxation (corporation tax, business rates).[334]

9.22. The logic for this is as much that Scottish citizens and taxpayers have certain expectations of what the Scottish Government would need to control in order to be a plausible locus of political authority, as that structural economic conditions require it to have certain sources of financing autonomy for it to act meaningfully and effectively in its areas of policy control.

9.23. **The APPTG believes that, given the growing devolutionary trends within the UK and across Europe, the long-term trend of these expectations is towards greater devolved control over a more extensive range of policy areas.** In other words, the degree of autonomy which Scotland enjoys under the *status quo*, or after the full implementation of the Scotland Act 2012, may be sufficient and satisfactory *now*, but is unlikely to remain so *in future*. The result is that, even if the immediate result after the 2014 referendum and negotiations conforms to Scenario 1, an outright 'No', there is likely to be continued (albeit delayed) pressure at a later date to remedy the revenue-raising/spending imbalance. **The APPTG suggests that this trend will eventually erode the fiscal outcome to that of a narrow 'No' result** (see §§5.30, 5.33, 6.95).

9.24. But at the same time, there are also exogenous factors which a more autonomous Scotland will have to deal with, irrespective of the referendum outcome, which emerge from the analysis in earlier chapters. First, it is clear that there would be a limit on the degree of *tax competition* between Scotland, the RUK, and other EU member states which would be tolerated, nationally and internationally. While tax competition introduces an important check on government by empowering businesses and forcing government to be more aware of the economic context in which policy is introduced, there is a risk that it can be taken too far, in the sense of fostering tax-régime-shopping within the British Isles.[335]

9.25. Both 'devo more' and independence offer Scotland clear ways of demonstrating that 'Scotland is open for business' and attracting companies in targeted sectors, but neither the RUK nor the EU would tolerate overly aggressive or radically detrimental Scottish fiscal 'raids across the border'.[336] **The APPTG believes that both Scotland and the UK need to focus more on the precise details of the constrained competitive environment in which a fiscally autonomous Scotland would be operating, in order to establish how much fiscal competition Scotland would be able to sustain.**

9.26. Second, a more autonomous Scotland will have to accumulate and develop both experience and credibility at being (more) fully *fiscally responsible*. The combination of any (or all) of inheriting a demographic share of UK government debt, losing the revenue-smoothing allocation under the Barnett formula or its alternative transfer mechanisms, and being exposed to market volatility in the value of North Sea oil revenue make for an "uncomfortable" context for sustaining high levels of government spending.[337]

9.27. The expectation on the Scottish Government under any greater degree of fiscal empowerment would be to show that it is not unequivocally "wedded to a high-tax-and-spend model", demonstrate the political will to prioritise certain areas of spending over others, (very probably) implement difficult decisions on spending cuts and tax rises, and (likely) abandon some of the universal free benefits which Scottish residents currently enjoy.[338] **The APPTG notes extensive scepticism regarding the possibility of being *both* "of the left" on taxation *and* fiscally responsible, and suggests that this dichotomous image is one that the Scottish Government will also have to work to dispel.**[339]

9.28. Third, the first two factors must be balanced with a (political and economic) need to find a way of effectively maintaining the Scottish Government's existing or inherited *fiscal commitments*.[340] The Scottish Government's ability to be fiscally inventive or adventurous is limited by the need for it to meet certain (substantial) expectations on the part of Scottish taxpayers of what it, as a plausible locus of political authority, should be doing—i.e., on what it should allocate expenditure, now and in future. The need to invest in sustainable

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[334] Kerevan, *Interview*.
[335] Campbell, *Interview*; Mawdsley and Payne, *Interview*.
[336] Hopkins, *Interview*.
[337] Sinton, *Interview*; Tom Peterkin, 'Scottish independence: "Oil can plug spending gap"', *Scotsman*, 13 June 2013.
[338] Miers, *Interview*.
[339] Mawdsley and Payne, *Interview*; Nicola McEwen, 'SNP must set out their welfare vision', *Scotsman*, 12 June 2013.
[340] Eddie Barnes, 'Spending review: SNP says Scots to keep pay rises', *Scotsman*, 27 June 2013.

infrastructure and vocational education, the increasing urgency of reform in the Scottish NHS, and the ongoing debate over the extent and universality of welfare spending will all have to be addressed, either at the UK level on Scotland's behalf (under 'devo more'), or directly by the Scottish authorities (under independence).[341]

9.29. Transitioning to reformed arrangements will have fiscal implications, and it is likely, on the basis of historical instances of secession, that a more empowered Scotland will need to run a fiscal deficit while it 'gets itself started'.[342] **The APPTG is concerned that the necessity of, and projected timescales for, such reforms have yet to figure in the current debate about Scotland's future solvency and financial stability.**

9.30. The result is that, for Scotland to be financially viable as an autonomous political region in the long-term, it must use the current period of recession and austerity to streamline and innovate its public sector.[343] As long as it is a part of the UK, Scotland is to some degree "shielded" from the urgency of instituting fiscal reforms—but while independence makes these reforms more necessary, it arguably makes them easier as well, as Scotland would not need to rely on the cooperation of the UK Government to overhaul public spending.[344]

9.31. With the exception of welfare, the capacity to streamline public services is already under the Scottish Government's control, which means that, whichever post-referendum scenario ultimately applies, structural innovation at the Scottish tier can, and inevitably must, form part of the eventual fiscal convergence.[345] **The APPTG believes that such reform would also be useful from an RUK perspective, as a way not only to *instruct* but also to *help achieve* the overarching project of public service reform, localisation of the welfare system, and greater fiscal discipline in the UK.**[346]

9.32. The areas where streamlining and reform can take place will depend to an extent on the areas in which a more autonomous Scotland will have meaningful freedom for fiscal innovation and variation. This will vary tax-by-tax, and hence to a degree, policy-area-by-policy-area, especially once revenue-raising powers are devolved to a comparable level to spending powers.

9.33. **Overall, the continued pressure for devolution and the constraints of international political economy are thus, in combination, likely to 'squeeze' the outcomes under each scenario together in the medium-to-long term.** The continued independentist tendency in Scotland (and other Celtic regions) will force an approximation of Scenario 1 towards Scenario 2 over time, while the additional steps beyond Scenario 3 'freed up' under Scenario 4 are arguably too radical to contemplate in the current international economic context, and unworkable in the context of expected future developments in European politics.

Conclusion

9.34. The clear indication is that, under current conditions, whatever the referendum result, Scotland will only be able to *diverge to a limited extent* from the fiscal principles and policies in effect under the *status quo* of asymmetric, embryonic devolution. This is not a problematic situation in itself, since even between extensively sovereign EU member states there is a high and increasing degree of convergence on fiscal policy.

9.35. Nonetheless, it is important to highlight that Scottish political economy of the future will be deeply path-dependent on, and bear a striking resemblance to, Scottish-UK political economy today—which means that the structural problems which face the UK now will continue to apply to Scotland, however far along the devolutionary continuum it ultimately progresses.

9.36. Another implication is that careful consideration must be given to the *sustainability of the pace of empowerment*: to whatever extent Scotland becomes autonomous from the UK, both the Scottish and UK Governments need

[341] Taylor, *Interview*; Eddie Barnes, 'Reality check needed on welfare costs', *Scotsman*, 26 June 2013.
[342] Henderson, *Interview*.
[343] Michael Settle and Magnus Gardham, 'John Swinney hints at protecting public sector pay', *Herald*, 27 June 2013.
[344] Taylor, *Interview*.
[345] Miers, *Interview*.
[346] Booth, *Interview*.

to ensure that institutional disruption is managed and minimised. This will involve a concerted effort on the part of both governments to offer guidance to individuals, businesses, and communities, especially *once negotiations after the referendum are complete*, and *once a concrete picture of new constitutional settlement for Scotland has emerged and been agreed.*

9.37. **The APPTG reiterates that Scotland's best interest involves detailed and continuous engagement between holders of different conceptions of what Scotland should look like in future—engagement which has been put on hold because of the competitive tone of the referendum campaign, but which must restart once the referendum outcome becomes clear.**

9.38. To illustrate the variable degree of leeway on fiscal policy which Scotland would enjoy, the table below gives an outline of two 'convergent' outcomes on 'either side' of the referendum result: a federal Scotland within the UK in the case of 'No', and a confederal Scotland within the EU in the case of 'Yes' (see table 9.1).

Table 9.1: Scotland's fiscal leeway after the referendum

Outcome	No	Yes
Institutional model	Federalism	Confederalism
Supranational body membership	UK (EU?)	EEA / EU
Currency	UK£	UK£ / Scot£ (pegged)
Income tax	9-11% SRIT operating range	±1% at each income tax rate level
NIC	Fixed at UK rates	1-3% below UK rates
Corporation tax	12.5-17% operating range	12.5-17% operating range
North Sea oil revenue	Earmarked for eventual devolution	Full geographical allocation to Scotland
VAT	20% (UK rate)	15-25% operating range
Excise duties	Part-devolved, part-assigned/reserved	Scottish authority but EU harmonisation
Other taxes (local, land, APD, aggregates levy)	Fully under Scottish authority	Fully under Scottish authority
Public expenditure funding model	75-85% self-responsible 15-25% block grant	100% self-responsible

10. Conclusion: Achieving autonomy

10.1. Given past developments in the Scottish Home Rule debate, and the parallel developments in related debates around Europe, the APPTG believes that the only possible future trajectory of Scottish autonomy will be one of significantly more extensive devolution, if not outright independence. In light of the precarious macroeconomic situation which European states face at this time, and will face for the foreseeable future, the predominant component of this empowerment will be fiscal, in order to let Scotland take greater control over its spending responsibilities.

10.2. The extent of autonomy which is aimed for in the next tranche of devolution of powers will depend on the extent of support which 'Yes' attains in the independence referendum in 2014, and on the consequent strength of the independentist or Unionist sides in the negotiations afterwards. The APPTG believes that the expected substantive content of this tranche can be broken down into four possibilities, corresponding to four different levels of support for 'Yes': *outright* 'No' (<40% 'Yes'), *narrow* 'No' (40-50% 'Yes'), *narrow* 'Yes' (50-60% 'Yes'), and *outright* 'Yes' (>60% 'Yes').

10.3. Under outright 'No', termed *concessive devolution*, there would be limited devolution beyond the full implementation of the Scotland Act 2012—and then, only to the extent recommended by the Calman Commission. Any further devolution may only take place as a result of a concerted 'National Conversation' about devolution, or in the form of direct empowerment of local government and urban authorities. The Barnett Formula would need to be replaced by a needs-based resource allocation mechanism; and tax revenue assignment might be used as a compromise between centralism and devolution.

In summary, in addition to powers under Scotland Act 2012:
- **Devolution of *air passenger duty* and *aggregates levy* ('full Calman');**
- **Devolution of *corporation tax* ONLY if pushed for collectively by devolved regions;**
- **Further devolution only through a UK-wide Constitutional Convention and '*National Conversation*' about devolution;**
- **Possible *direct empowerment of local government and urban centres* in lieu of regional devolution;**
- **Shift from the Barnett Formula to a recalculated regional *needs-based resource allocation*;**
- **Greater use of *tax assignment* as compromise between centralism and devolution.**

10.4. Under narrow 'No', termed *aspirational devolution*, there would be extensive devolution of those revenue sources not legally or pragmatically restricted to the central tier. Employees' National Insurance Contributions would have to remain reserved to preserve the core of the 'social Union', and VAT could be at most assigned under EU rules. Fuel and betting duties and alcohol and tobacco duties could be respectively pragmatically reserved and assigned, or assigned by an *ad hoc* calculation and devolved, and North Sea oil revenue and corporation tax could be respectively reserved and assigned, or geographically allocated and devolved, depending on the UK and Scottish Governments' aversion to revenue volatility. All other taxes would be devolved, with the shortfall in public expenditure financing made up by borrowing and a UK fiscal transfer mechanism.

In summary, in addition to powers under *concessive devolution*:
- **Significant degree of *fiscal convergence and restraint* enforced by *retention of UK£* and current macroeconomic conditions;**
- ***Tax harmonisation and fiscal prudence* mitigating autonomy with *EU membership* (through UK);**
- **Likely operating range of *corporation tax*: 12.5-17%;**
- **Likely operating range of *income tax*: equivalent to SRIT of 9-11p on top of (UK rate – 10p) calculation;**
- **Likely *VAT* rate determined by formula:** $VAT_{Scot}(\%) = VAT_{UK}(\%) - h_{EU} - r_{UK}$.

10.5. Under narrow 'Yes', termed *concessive independence*, all taxes would (eventually) have to be transferred, and any form of block grant from the UK—as well as any tax payments from Scotland to the UK Exchequer—discontinued. However, the 'Yes Scotland' campaign's commitment to retaining the UK£ and applying for EU membership would impose significant requirements for (indefinite) fiscal restraint and tax harmonisation on the Scottish Government. The major components of Scottish tax revenue—income tax, corporation tax, NICs and VAT—are likely to be able to deviate from the extant UK levels by only 1-2%, often with an absolute maximum deviation of 5%.

In summary, in addition to powers under *concessive* and *aspirational devolution*:

- **Full *constitutional separation* from RUK governance and legal institutions;**
- **Discontinuation (beyond transition) of the *block grant* from Westminster to Holyrood;**
- **Responsibility for, and control over, all taxes *fully transferred* to the Scottish Government;**
- ***Double non-independence* as a result of *retention of UK£ and EU membership*, though latter (possibly) only guaranteed by leaving the UK;**
- **Significant degree of *fiscal convergence and restraint* enforced by (possible) retention of UK£ and current macroeconomic conditions, without foreseeable end-point;**
- ***Tax harmonisation and fiscal prudence*, though not necessarily adoption of the euro, mitigating autonomy under effective popular conception of 'devo max' with EU membership;**
- **Likely operating range of *corporation tax*: 12.5-17%;**
- **Likely operating range of *income tax*: ±1% at each income tax rate level;**
- **Ability to lower rate for *NICs* by 1-3 'points' relative to current level;**
- ***VAT* required by EU membership, likely rate in range of 15-25%.**

10.6. Under outright 'Yes', termed *aspirational independence*, Scotland would be plausibly able to consider lifting the two constraints of retaining the UK£ and EU membership in favour of moving to a separate Scot£ (transitionally pegged to UK£) and 'weaker' attachment to Europe through EEA membership. These would make the fiscal restraint requirements under currency union temporary, and the pull towards harmonisation less strong—although, in practice, the need for fiscal sustainability and market credibility would only add an extra 1-2% onto Scotland's maximum capacity for deviating from current UK rates.

In summary, in addition to powers under devolution and *concessive independence*:

- ***Constrained independence* as a result of *temporary retention of UK£* until floating-off of Scot£ and *EEA membership*, as complete 'going it alone' is unsustainable long-term;**
- **Significant degree of *fiscal convergence and restraint* enforced by transitional retention of UK£ and current macroeconomic conditions, with end-point fixed at when Scot£ floats off;**
- ***Tax harmonisation* mitigating autonomy with EEA membership, due to 'ratchet effect' of *de facto* approximation of EEA member policy to *de jure* integrated EU members;**
- **Likely operating range of *corporation tax*: 10-17%;**
- **Likely operating range of *income tax*: ±1% at each income tax rate level;**
- **Ability to lower rate for *NICs* by 1-3 'points' relative to current level;**
- ***VAT* not required but still best sales tax option, likely rate in range of 8-25%.**

10.7. From the analysis of these four scenarios for a post-referendum Scotland, it is possible to draw out two main observations, which the APPTG suggests should be borne in mind in future assessments of Scottish autonomy. Firstly, the exact degree of autonomy which Scotland ultimately attains from the UK depends heavily on three factors, two subjective, one contingent:

→ The vision of the relationship between the regions of the British Isles subscribed to—i.e., the acceptability of tax competition, or the prioritisation of maintaining the 'social Union';

→ Confidence in the ability of the Scottish Government to steer a stable course for the Scottish economy, and concern about the possibility of punitive speculation by the markets;

→ Whether or not Scotland stays in a currency union with the UK.

10.8. Secondly, it is clear that in all four scenarios, *some form* of inter-governmental negotiations are unavoidable, not least to clear up definitional ambiguities, administrative difficulties, and the two governments' mutual perception of political and economic influence. The APPTG thus reiterates the call for formal, open, transparent consideration to be given to the contingency planning which both governments, as well as individuals, businesses, and communities, will otherwise have to engage in clandestinely, less effectively, with less information, and on a more *ad hoc* basis.

10.9. As a result of these two observations, the APPTG proposes two theses to model the autonomy debate in a post-referendum Scotland. Firstly, the *continuum thesis* argues that there exists a large and diverse range of options for greater fiscal autonomy, which are narrowly gradated along a 'sliding scale' of empowerment according to the extent of control Scotland exercises over each tax area. The current trend of public opinion favours a gradual progression along this continuum, with inevitable constitutional implications for the strength and nature of the Union as a mechanism for social cohesion.

10.10. Secondly, the *convergence thesis* suggest that, due to practical fiscal constraints, a more autonomous or fully independent Scotland would be restricted to a limited degree of variation from the *status quo* of taxation policy, despite exercising technical decisive control over the areas of policy in which it is empowered. At the same time, the long-term trend under devolution would be for the Scottish Government to push for the maximum degree of fiscal empowerment stably, or technically, compatible with the maintenance of the 'social Union'.

Table 10.1: Summary of the expected effects of the 2014 referendum

Outcome	No	Yes
Institutional model	Federalism	Confederalism
Supranational body membership	UK (EU?)	EEA / EU
Currency	UK£	UK£ / Scot£ (pegged)
Income tax	9-11% SRIT operating range	±1% at each income tax rate level
NIC	Fixed at UK rates	1-3% below UK rates
Corporation tax	12.5-17% operating range	12.5-17% operating range
North Sea oil revenue	Earmarked for eventual devolution	Full geographical allocation to Scotland
VAT	20% (UK rate)	15-25% operating range
Excise duties	Part-devolved, part-assigned/reserved	Scottish authority but EU harmonisation
Other taxes (local, land, APD, aggregates levy)	Fully under Scottish authority	Fully under Scottish authority
Public expenditure funding model	75-85% self-responsible 15-25% block grant	100% self-responsible

10.11. The APPTG's insights here are subject to three caveats. Firstly, the APPTG emphasises that much of the analysis above has been targeted at the short-term 'picture' for Scotland, with specific reference to the settlement that would need to be reached and agreed-on after the post-referendum negotiations, regardless of the result. This settlement, of course, will be far from the 'end point': however Scotland votes in 2014, the possibility will remain for it to transition to 'more autonomy' in future, as it begins to 'find its feet' as an increasingly distinct and self-directing political entity. Further, the analysis above does not account for the fact that the fiscal policies and priorities of both the RUK and EU will almost inevitably change and evolve over the coming decades, which will have implications for the legal and normative constraints within which Scottish fiscal policy must operate.

10.12. Secondly, much of the analysis above is *of necessity* short-sighted, since the prospects for radical changes in tax rates and levels of receipts in Scotland are extensively hampered by the current climate of austerity, the taking-on of a demographic share of UK debt, and the need for Scotland to use its oil revenue to help reduce its public sector deficit. Of course, problems such as the high risk premium on Scottish debt interest and its initial lower credit rating might disappear after a few years of demonstrable fiscal prudence on the part of the Scottish Government. However, the timescale on which that might take place is extremely hard to predict, so the analysis here has confined itself to the scope for Scottish fiscal empowerment, given the *status quo* of the UK tax régime.

10.13. Thirdly, the percentage-splits associated with the definitions of 'narrow' and 'outright' in the four scenarios may not be quite as hard-and-fast as suggested. Specifically, the *supermajoritarian* cut-off point of a 60% majority in favour of 'Yes' or 'No' as marking the boundary between 'narrow' and 'outright' victory could be more expansively framed as a 66% majority, as is the case in several Commonwealth systems. There could thus be a 'grey area' between 60% and 66% for 'No' and 'Yes' in Scenarios 1 and 4 respectively, such that the substantive and strategic implications of a result in that area would be subject to the interpretation of the two campaigns. Nevertheless, the percentages offer a useful guideline in principle for how the 'Yes Scotland' and 'Better Together' campaigns might approach the negotiations in the case of each result, ideally with the effect of facilitating each side's formulation of 'opening gambits' going into the negotiations.

11. Recommendations

11.1. The national and sub-national conversations taking place over secessionist movements in other European regions concerned should be used to productively inform the debate on Scotland's future (§1.3).

11.2. The current debate should draw on past autonomy arguments to contextualise the argument's dividing lines, and use previous attempts to resolve the tension between London and Edinburgh to inform the trajectory of devolved policy after the referendum takes place (§1.14).

11.3. Both sides in the debate must concretise their views of what kind of society Scotland ought to become, specifically their arguments regarding the various choices for Scotland, in the context of both a 'Yes' and a 'No' vote (§2.16).

11.4. Both the Scottish and UK Governments must acknowledge their duty of guidance towards individuals, businesses, and communities in Scotland and the RUK, which cannot be abrogated, or offloaded by either tier onto the other (§3.11).

11.5. Increases in Scotland's fiscal autonomy must not be rushed through, but rather implemented carefully and thoroughly, if necessary with the support of external experts, and with due concern for the capacity of those affected by those increases to adjust to them (§§3.25, 3.26, 3.29).

11.6. The Calman Commission's recommendation that changes in Scotland's empowerment should be introduced in a phased way to manage the risks of instability in public finances should be taken extremely seriously for any future tranches of fiscal devolution (§3.30).

11.7. The Scotland Acts 1998 and 2012 must not be seen as isolated pieces of devolution legislation, but as a more general endorsement of the success of the principle of greater empowerment for Scotland, and hence as a basis for greater transfer of powers in future (§§3.32, 9.10).

11.8. In the absence of explicit consideration of full independence as a plausible option from assessments of Scotland's constitutional position so far, researchers and policy-makers must provide exploratory analysis that takes the possibility of independence seriously, with the same degree of rigour as past assessments, at least until September 2014 (§3.40).

11.9. Both sides in the autonomy debate should focus on aligning the substantive content of the post-referendum negotiations as far as possible with the result of the 2014 referendum, rather than relying on a second referendum to ratify the outcome of inter-governmental negotiations (§4.13).

11.10. The arguments in the autonomy debate must focus on those issues with major financial implications, out of those about which the public exhibit the greatest uncertainty, as these are the most pressing in the current macroeconomic climate (§4.17).

11.11. Researchers should examine the comparability of the UK's model of asymmetric devolution with the principle of variable geometry that is gaining currency at the European level, in order to understand the relationship between devolution and the maintenance of the 'social Union' (§§5.7, 5.8).

11.12. The UK Government should formally commit to holding a 'National Conversation' about devolution, and instigating a nationwide approach to answering national, regional, and local constitutional questions immediately after the referendum in September 2014, regardless of the outcome (§5.21).

11.13. Given the nationwide trend towards regionalism and localism, the Westminster parties should all consider formally endorsing efforts to strengthen devolution and deepen regional autonomy, in order to establish the credibility of their commitment to meaningful regional empowerment (§5.23).

11.14. In the case of a 'No' vote, the Barnett Formula must be replaced as a priority, with a needs-based formula for inter-regional resource allocation the best alternative, using the seven indicators of relative need identified by the Holtham Commission (§§5.26, 6.84).

11.15. This new calculation must be negotiated with the involvement of not just the UK, Scottish, Welsh, and Northern Irish tiers of governance, but also London and the other English regions, to avoid the persistence of relative imbalances in public spending (§5.27).

11.16. The post-referendum inter-governmental negotiations must be undertaken with great care, especially under a 'No' result, to avoid breakdown into unproductive acrimony (§6.5).

11.17. Negotiations after a 'No' vote should be considered as an occasion to explore the kinds of 'third option' between the *status quo* and independence that might be possible, using analysis designed to establish the limits of the compatibility between fiscal devolution and political union between Scotland and the UK (§§6.6, 6.9).

11.18. Government Expenditure & Revenue Scotland should strongly consider developing a more sophisticated method of calculating the proportion of corporation tax due in Scotland than the *ad hoc* measure used currently, such as regionalised tax receipts (§6.21).

11.19. The autonomy debate, and post-referendum negotiations, must not focus too heavily on corporation tax, at the expense of much-needed discussion of other aspects of fiscal autonomy, in part due to the effect of long-term shrinking corporation tax revenues (§6.35).

11.20. In the case of the Scottish Government gaining the ability to vary tax rates, a balance must be struck between Scotland varying rates to demonstrate its policy independence from the UK and implementing changes that are effective in promoting growth in the Scottish economy (§6.36).

11.21. Given their significantly greater contribution than corporation tax to total Scottish tax revenue, income tax, VAT, NICs, and excise duties should be prioritised in discussions over devolution or assignment after a 'No' vote (§6.38).

11.22. The ability to define the principles on which a tax and social security system operates should be considered a vital criterion in the establishment of a distinct identity for the Scottish polity (§6.48).

11.23. Given the importance of maintaining an identitarian link between 'Scottish tax' and 'Scottish spending', devolved competitiveness and complexity in the tax system must take priority over centralised cohesiveness and simplification (§§6.50, 6.68).

11.24. Further fiscal empowerment of Scotland should not be undertaken with each tax considered in isolation, as many tax powers need to be transferred 'hand in hand' to be fully effective (§6.76).

11.25. Future analysis must answer procedural questions over the order in which powers should be devolved to Scotland, with the possibility of creating a roadmap to guide how any move to giving Scotland greater autonomy should be implemented (§§6.77, 9.5).

11.26. Devolution analysis must consider in greater detail ways of balancing tendencies towards federalism and localism, in order to ensure that these do not become mutually contradictory or destructive in practice (§6.82).

11.27. In the case of a 'Yes' vote, there needs to be some form of stringent agreement between the Scottish and UK Governments that addresses the implications for the UK of Scotland's continued use of UK£ (§7.16).

11.28. Independence for Scotland should be seen as an effective move from one Union (the UK) into another (the EU), especially as regards the satisfaction of Scottish popular preferences for the policy responsibilities which the Scottish Government should have control over (§§7.29, 7.31).

11.29. Consideration should be given to membership of the EEA or EFTA as an alternative to EU membership, in order to further the options available for Scotland in the case of a 'Yes' result in the referendum (§8.18).

11.30. Given the effect of greater Scottish autonomy on taxpayers with over-the-border activity, discussions between the Scottish and UK Government should not be delayed until after the referendum (§§9.16, 10.4).

11.31. Both Scotland and the UK must focus more on the precise details of the constrained competitive environment in which a fiscally autonomous Scotland would be operating, in order to establish how much fiscal competition Scotland would be able to sustain (§9.25).

11.32. The Scottish Government must establish a credible compatibility between endorsing progressive taxation and practising fiscal responsibility, given the current macroeconomic climate (§9.27).

12. Appendix: Methodology

12.1. 'Achieving Autonomy' is the culmination of a research project that was launched on 24th November 2012. It is produced on behalf of the APPTG, which is dedicated to look at and understand tax policy and taxation at all levels in the UK; to contact and talk to accountants and officials from HM Revenue & Customs; and to look at European tax affairs and international taxation.

12.2. The APPTG's mandate for the author of this report—Marius Ostrowski—was to consider the impact of the independence referendum in September 2014 on Scotland's future fiscal autonomy and to lay the interpretative framework for a series of APPTG reports in this series.

12.3. The research methodology for this study involved a range of interviews and meetings with organisations and people involved with the implementation. This includes but is not limited to officials at HM Revenue & Customs and Revenue Scotland; researchers at thinktanks in Scotland and the RUK; payroll software companies; industry representatives; tax specialists and academics; tax advisors and accountants; and businesses and individual taxpayers. Information was also obtained through Parliamentary Questions asked by the APPTG's Chairman Ian Liddell-Grainger MP.

12.4. The research methodology includes a range of primary as well as secondary sources. These include but are not limited to past APPTG reports; reports by both HM Government and the Scottish Government; select committee reports on tax, constitutional affairs, and economic affairs; answers to parliamentary questions; and academic papers on fiscal policy, Scottish autonomy, and tax devolution.

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