



Supporting Business and Enterprise

Taking forward
our National
Conversation

Choosing Scotland's Future

A National Conversation

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Foreword by the Cabinet Secretary for Finance and Sustainable Growth

The overriding Purpose of this Government is clear: to focus the Government and public services on creating a more successful country, with opportunities for all of Scotland to flourish, through increasing sustainable economic growth. The recession has provided further evidence - if any were needed - for the Scottish Government to have greater autonomy to manage the Scottish economy and improve the environment for Scottish business. Experience of the last 30 years demonstrates that the status quo has not delivered sustainable economic growth in Scotland which matches UK performance, or indeed the performance of similar and independent nations.

It is now time for a new approach that gives Scotland responsibility for the economic levers that will allow us to reach our full potential as a nation. There is now a clear consensus that the devolution settlement put in place 10 years ago should move forward. We need to embrace that opportunity, and recognise that in moving forward our priority must be a new settlement that allows us to achieve the best outcomes for Scotland. The realities of the European Union, with a single market and open borders, mean that whether as part of the UK or an independent nation Scotland would continue to trade within a European home market of 500 million people, removing once and for all old fears and scare stories about access for Scottish business. Our social, cultural and economic links will be sustained as we build a new, more modern and indeed more appropriate partnership with the other nations on these Isles, and more widely the other nations of Europe. We will continue to work with business - as we do at present - and take full account of their views. We want Scotland's wealth creators to have the best possible conditions to grow successful businesses, with a more competitive Scotland that becomes one of the very best places to do business in Europe.

The Scottish Government is fully committed to encouraging and nurturing a supportive business environment. Businesses are the key to delivering accelerated and sustainable economic growth. With greater autonomy or in an independent Scotland we would therefore look to build on current factors that provide comparative business advantage, with new initiatives such as lower corporation tax to give companies in Scotland a new competitive edge and to attract new businesses to Scotland. Improvements to the business environment would be focused on supporting infrastructure, innovation and entrepreneurship with a view to fostering improved growth and productivity in the Scottish economy. The ability to borrow would also allow us to improve connectivity in Scotland at a faster rate and enable increased investment when it was needed in the Scottish economy.

This paper makes clear that there are many such opportunities to support business better. Like all National Conversation papers, this analysis is intended to prompt further discussion and thought and we in the Scottish Government welcome on-going debate regarding the issues covered by this paper.

John Swinney MSP

Cabinet Secretary for Finance and Sustainable Growth

Executive Summary

Introduction

- This document describes options for new constitutional arrangements and how Scotland's business competitiveness and sustainable economic growth could be improved.
- It takes account of National Conversation events and discussions which have taken place across Scotland. Discussion - with business, Trade Unions, the UK Government and others - will continue as an integral element of optimising Scottish Government support for business and enterprise.
- Scotland's businesses are the primary driver of economic growth and increasing their size, competitive strength, productivity and ambition is a crucial challenge.

Scotland Today

- In the last 10 years devolution has delivered some clear benefits for Scottish businesses and communities. Devolution was always expected to evolve further to meet Scotland's emerging needs.
- Many of the key policy levers relating to supporting businesses and enterprise and improving business infrastructure are reserved to the United Kingdom at present.
- Experience of the last 30 years demonstrates that the status quo will not deliver sustainable economic growth in Scotland which matches UK performance, or indeed the higher levels of long-term growth enjoyed by similar, independent nations.

The Commission on Scottish Devolution Recommendations

- In terms of support for business and enterprise in Scotland, the Commission on Scottish Devolution's report featured recommendations on: tax and borrowing, including Air Passenger Duty; employment policy and industrial relations including health and safety and migration policy; and trade and commerce.
- Most recommendations, although well-intentioned, continue to constrain the Scottish Government, businesses and economic growth. Others have the potential to damage the management of Scotland's public finances.
- We believe the Commission has failed to recognise or address the comparative under-performance of the Scottish economy within the UK.

Enhancing and maximising devolution

- The Scottish Government is keen to examine how the existing devolution model might be enhanced to include full fiscal autonomy and the transfer of a range of other responsibilities vested in the UK Government - and believes doing so would provide real business benefits for Scotland.

- The Scottish Government is committed to making Scotland one of the best places to do business in Europe, by for example reducing the rate of corporation tax to significantly below the UK level.
- However, under any enhanced devolution model, a range of rules and commitments imposed by the UK would continue to constrain the policy levers available to the Scottish Government, thereby sustaining factors which have historically impaired Scotland's growth performance and competitiveness.

Independence

- Only independence allows Scotland the freedom to use the full levers of government to create a more successful country, with opportunities for all of Scotland to flourish, through increasing sustainable economic growth.
- Business and enterprise benefits would emerge from outcome-focused reform of, for example: fiscal and tax policy and collection arrangements; competition and consumer policy; financial services regulation; promotion of international trade; skills and immigration; and transport infrastructure.
- The rest of the UK would remain our closest partner and ally and an independent Scotland would clearly seek to focus policy to enhance trading and other economic opportunities within the British Isles.
- An independent Scotland would enable government to be more responsive to local economic needs. There would be an opportunity for more effective and streamlined decision making processes, allowing government to work closely with the business community to create the conditions for successful businesses and for talented people to live, learn, visit, work and remain in a more prosperous nation underpinned by higher levels of sustainable economic growth.

Conclusions

- The Scottish Government's considered position is clear. Only independence allows Scotland the freedom to use the full responsibilities of government to *create a more successful country, with opportunities for all of Scotland to flourish, through increasing sustainable economic growth.*
- In moving forward, the Scottish Government would remain focused on fostering a supportive business environment and improving the competitiveness of businesses in Scotland. The aim would be to build on current areas of comparative advantage. Improvements to the business environment would be focused on supporting innovation and entrepreneurship with a view to fostering improved growth and productivity in the Scottish economy.

1

Introduction

Chapter Summary

- This document describes options for new constitutional arrangements and how Scotland's business competitiveness and sustainable economic growth could be improved.
- It takes account of National Conversation events and discussions which have taken place across Scotland. Discussion - with business, Trade Unions, the UK Government and others - will continue as an integral element of optimising Scottish Government support for business and enterprise.
- Scotland's businesses are the primary driver of economic growth and increasing their size, competitive strength, productivity and ambition is a crucial challenge.

1.1. This document forms part of the ongoing National Conversation, which aims to promote an inclusive, open and full debate about available constitutional options. As the culmination of this engagement, we will publish a White Paper on St Andrew's Day 2009. We will then introduce a Referendum Bill to Parliament in 2010 so that a referendum can be held on Scotland's constitutional future.

1.2. It outlines some of the main options available to Scotland and illustrates whether and how Scotland's business competitiveness could be promoted:

- A. Within the current arrangements since the Scottish Parliament was established in 1999;
- B. By incorporating the minor adjustments recommended in this area by the Commission on Scottish Devolution;
- C. Through the opportunities which could be available to Scotland under a highly decentralised model, still within the United Kingdom, but with increasing rights and responsibilities falling to the Scottish Parliament and Government;
- D. Under independence.

1.3. In each context a key test is improving the capacity of Government to create the best possible environment for competitive businesses, entrepreneurship and innovation to flourish.

1.4. The document is therefore focused on business and enterprise, and the transport and other infrastructure which supports them. It does not have a sectoral dimension, although it takes account of the diverse series of National Conversation events and discussions which have taken place across Scotland. Discussion - with business, Trade Unions, the UK Government and others - will continue as an integral element of optimising

1 Introduction

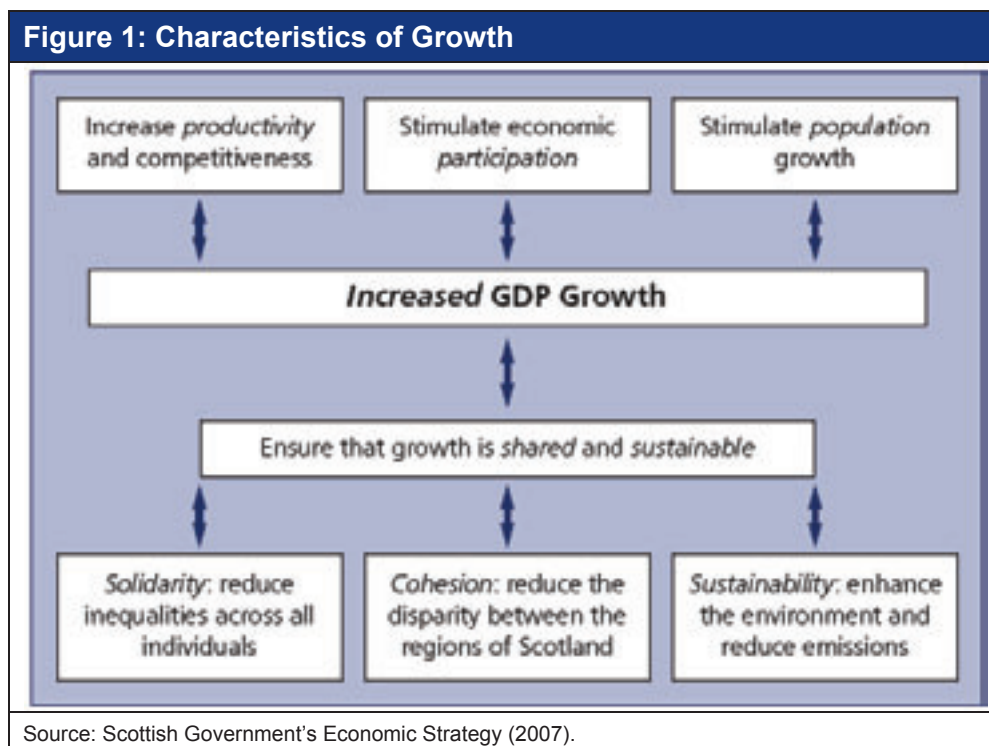
Scottish Government support for business and enterprise. It also builds on the series of National Conversation documents published in 2009, and in particular:

- Fiscal Autonomy in Scotland: The case for change and options for reform
- Europe and Foreign Affairs - A new and better way for Scotland
- The Scottish Government Response to the Recommendations of the Commission on Scottish Devolution
- Employability & Skills: Taking Forward our National Conversation
- Energy: Taking Forward our National Conversation

1.5. These options are also considered in the context of the strategic priorities set out in the Scottish Government's Economic Strategy, which focused central government and the wider public sector on supporting businesses and individuals to deliver a shared Purpose:

creating a more successful country, with opportunities for all of Scotland to flourish, through increasing sustainable economic growth.

1.6. The Strategy, though focused on what can be achieved within the existing responsibilities of the Parliament, forms a key part of the Government's National Conversation because of the extent to which a broader set of economic levers would promote increasing sustainable economic growth.



1.7. The broader benefits of delivering the Government's Purpose will be shared by all of Scotland, enabling people and businesses to prosper through more and better-paid employment and making Scotland a more attractive place to live, work and invest. Through the generation of resources that delivery of the Purpose will bring, government in Scotland will be empowered also to provide better quality public services and additional choices and opportunities for Scotland's people.

1.8. In order to deliver increasing sustainable economic growth and meet the Government's targets, the Government has identified five *Strategic Priorities* that are

internationally recognised as critical: infrastructure and place; learning, skills and well-being; a supportive business environment; effective government; and equity. Sustainable economic growth means building a dynamic and growing economy that will provide prosperity and opportunities for all, while ensuring that future generations can enjoy a better quality of life too. The Government's Purpose is underpinned by a set of challenging targets that track progress in boosting the long term drivers of economic growth – productivity, population and participation – and in delivering on the desired characteristics of growth – solidarity, cohesion and sustainability (see Figure 1).

1.9. Each of these is critical to the delivery of the Purpose and they are embedded in and emphasised throughout the Government's approach. The remainder of this document is focused on the potential additional opportunities associated with available constitutional options and specifically how to support businesses better. Scotland's businesses are the primary driver of economic growth and increasing their size, competitive strength, productivity and ambition is a crucial challenge. We all want Scotland to be wealthier and fairer. We all want to live in a Scotland that is one of the most attractive places for business in Europe.

Overview

1.10. The report is structured as follows:

- Chapter 2 discusses the current devolution settlement, the benefits delivered for Scotland and remaining constraints on economic and business growth;
- Chapter 3 considers the relevance and impact of the Commission on Scottish Devolution recommendations in the context of business and enterprise, and transport infrastructure;
- Chapter 4 examines options for enhancing business and economic performance by maximising devolution and limitations likely to remain;
- Chapter 5 outlines options available to an independent Scotland to better support the business environment, boosting competitiveness and accelerating sustainable economic growth; and
- Chapter 6 presents conclusions.

2 Scotland Today

Chapter Summary

- In the last 10 years devolution has delivered some clear benefits for Scottish businesses and communities. Devolution was always expected to evolve further to meet Scotland's emerging needs.
- Most key policy levers relating to supporting businesses and enterprise and improving business infrastructure are reserved to the United Kingdom at present.
- Experience of the last 30 years demonstrates that the status quo will not deliver sustainable economic growth in Scotland which matches UK performance, or indeed the higher levels of long-term growth enjoyed by similar, independent nations.

2.1. It is now 10 years since the Scottish Parliament was established, giving the people of Scotland a direct democratic voice in decisions across a wide range of government activities already administered in Scotland. The Scottish Parliament and Scottish Government have responsibility for many policy areas that affect Scotland's economic performance.

2.2. The Government's Economic Strategy describes how those policy levers are being used to support businesses and develop related infrastructure. In the context of the global recession, the Government's Economic Recovery Plan sets out how full use of all existing levers is supporting economic recovery and sustainable growth during these difficult times, by focusing on three key areas:

- Supporting jobs and communities
- Strengthening education and skills
- Investing in innovation and the industries of the future.

2.3. All of these factors come together in the context of transport infrastructure. With the majority of transport functions devolved, including some post-1999, the Scottish Government has put in place distinctive policies designed to create a well-connected, safe and reliable transport system which underpins business and economic growth as well as providing the people of Scotland with a range of wider benefits.

2.4. The experience of enhanced rail devolution (Box 1) demonstrates what more Scotland can achieve with greater responsibility for policy and delivery and a strong focus on objectives for the specific benefit of the Scottish people. The Scottish Government's view is that further constitutional reform would allow such achievements to be replicated in other areas of policy and delivery.

2.5. The starting point for further improvement is of course the current devolution settlement. From the outset there has always been recognition that the responsibilities of the Scottish Parliament and Scottish Government could be extended.

Box 1: Benefits of Devolution: Rail Services

In 2005, responsibility for railways in Scotland was transferred to Scottish Ministers following the passing of the Railways Act 2005. Before then, rail investment decisions were taken at UK level and important Scottish projects competed for priority status in a hierarchy set by the UK Government. Opportunities to benefit the Scottish economy were missed.

Since 2006, the Scottish Government has taken forward a range of investment projects in Scotland that may not have been achieved at a UK level, as they would potentially have competed for funds against projects in areas with larger population densities and greater congestion in larger English cities.

In July 2007, the Scottish Government took an independent approach from the UK Government to Network Rail's High Level Output Specification. For the first time, the Scottish Government specified industry deliverables on behalf of Scottish rail passengers and freight users, with a view to securing the most positive outcomes for Scotland. Different priorities included a focus on faster journey times to benefit business, which has resulted in substantial planned investment in the important Glasgow to Edinburgh line and from Inverness and Aberdeen to the central belt.

Responsibility for investment decision-making has allowed the Scottish Government to target investment in the Scottish rail network to most effectively meet Scottish Government objectives. These objectives go beyond the rail specific, such as improving connectivity, to the challenging climate change targets recently agreed by the Scottish Parliament.

Under the direct authority of Scottish Ministers, the ScotRail franchise has delivered improved performance, with delays for the year to March 2009 12% lower than the previous year compared with 2.4% across the UK as a whole.

2.6. The Scotland Act 1998 reserves respectively to the United Kingdom Government and to the United Kingdom Parliament executive and legislative powers in relation to the large range of matters listed in full at Schedule 5 to the Scotland Act. The reservations which are most relevant to business and enterprise are:

Constitutional and general reservations

- Foreign affairs, international relations, and representation.

Financial and economic matters

- Fiscal, economic and monetary policy, including the setting of interest rates, the vast majority of taxes and excise duties, government borrowing and lending, control over United Kingdom public expenditure, the exchange rate and the Bank of England.
- The currency: coinage, legal tender and bank notes.
- Financial services.
- Financial markets, including listing and public offers of securities and investments, transfer of securities and insider dealing.

Home affairs

- Immigration and nationality.

Trade and industry

- The creation, operation, regulation and dissolution of types of business association.
- Insolvency in relation to business associations.
- Regulation of anti-competitive practices and agreements; abuse of dominant position monopolies and mergers.
- Intellectual property.
- Import and export control.
- Consumer protection.
- Product standards, safety and liability.
- Weights and measures.
- The Post Office, and postal services.
- Designation of assisted areas.
- Protection of trading and economic interests.

Transport

- Roads - regulation governing use of roads, vehicle standards, driver and vehicle licensing and driver training, operator licensing regime and enforcement for HGVs and PSVs, national speed limits, and renewable Transport Fuels Obligation.
- Rail - GB wide rail network issues, policing, responsibilities under the Disability Discrimination Act, standards and regulation frameworks, representation of passenger interests and complaints, and specification of cross-border franchises.
- Marine - marine regulation and policy, internal, international and cross border shipping policy and security, and design regulations for passenger accessibility on ferries.
- Aviation - economic, security and safety regulation, and international representation.

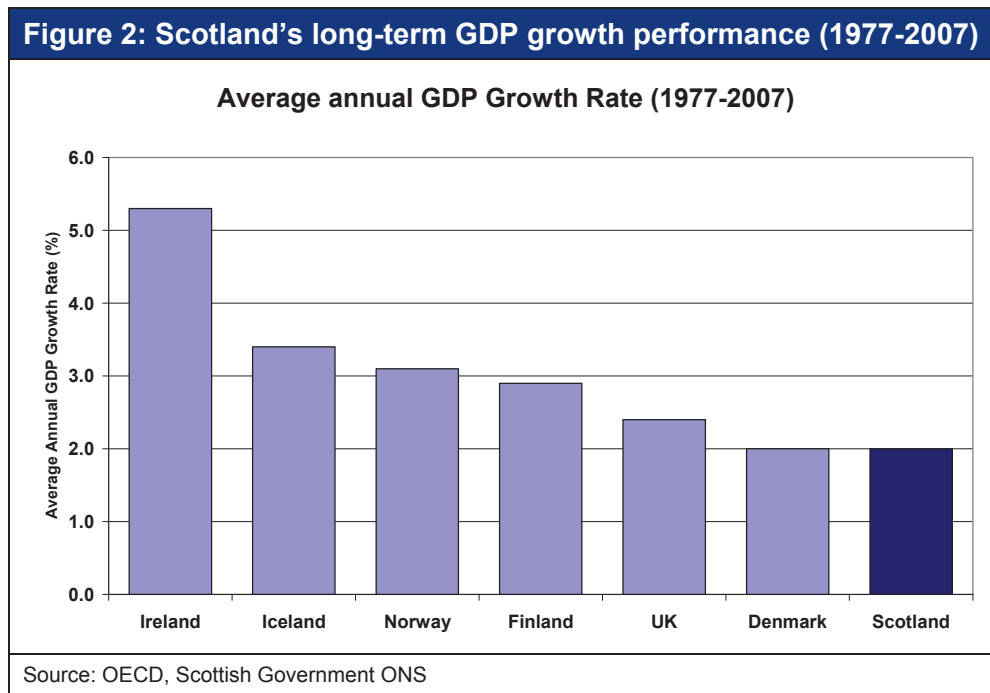
Employment

- Employment rights and duties and industrial relations.
- Health and safety.
- Job search and support.

2.7. The Scottish Parliament and Scottish Government have responsibility for many policy areas that affect Scotland's economic performance, and in particular have responsibility for enterprise interventions. However as shown above many key policy levers are reserved to the United Kingdom. This includes the key roles on regulation and competition, including the responsibilities of the Office for Fair Trading, the Competition Commission, the utility regulators and the promotion of trading interests by UK Trade & Investment.

2.8. Experience of the last 30 years demonstrates that the status quo has not been able to deliver sustainable economic growth in Scotland which matches UK performance overall. Scotland's economic growth has underperformed relative to both the UK, and other small European countries, in recent decades. Figure 2 shows that between 1977 and 2007, Scotland's average annual GDP growth was 2.0 per cent, lower than the average growth rate in the UK of 2.4 per cent, and significantly below the growth rate among comparable small European countries of 2.7 per cent. Scotland's growth has also lagged that of the UK, in nine out of the past ten years.

2.9. Scotland's businesses are the primary driver of economic growth and increasing their size, competitive strength, productivity and ambition is a crucial challenge.



2.10. Under the existing devolution settlement Scotland lacks the full set of levers for building a wealthier and fairer nation. That is something we cannot and should not accept.

3 The Recommendations of the Commission on Scottish Devolution

Chapter Summary

- In terms of support for business and enterprise in Scotland, the Commission on Scottish Devolution's report featured recommendations on: tax and borrowing, including Air Passenger Duty; employment policy and industrial relations including health and safety and migration policy; and trade and commerce.
- Most recommendations, although well-intentioned, continue to constrain the Scottish Government, businesses and economic growth. Others have the potential to damage Scotland's fiscal position.
- We believe the Commission has failed to recognise or address the comparative under-performance of the Scottish economy within the UK.

3.1. The Commission on Scottish Devolution was set up by the Scottish Parliament and the United Kingdom Government 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 serve the people of Scotland better, improve the financial accountability of the Scottish Parliament, and continue to secure the position of Scotland within the United Kingdom".

3.2. The Commission's final report "Serving Scotland Better: Scotland and the United Kingdom in the 21st Century" was published in June 2009 and concluded that:

"the UK is an economic Union with a very integrated economy, with goods and services traded within it all the time. We are absolutely clear that this economic Union is to Scotland's advantage and in considering how devolution should develop we have been very careful not to make recommendations that will undermine it. Many devolved responsibilities are important for economic growth, and are most effectively run by the devolved bodies, but the Scottish Parliament and Government cannot run a separate macro-economic policy without threatening the benefits of this economic Union. This is also important for taxation, because the scope to have different rates of tax inside a single economy is limited."

3.3. A key recommendation (in turn underpinned by a set of operational recommendations) proposed that part of the Budget of the Scottish Parliament should in future be found from devolved taxation, rather than from the grant from the UK Parliament. The main means of achieving this would be through the UK and Scottish Parliaments sharing the yield of income tax, alongside devolution of a small number of taxes (Air Passenger Duty, Aggregates Levy, Landfill tax and Stamp Duty land tax). However, the Commission's recommendations amount to little real improvement in the degree of autonomy afforded to Scotland. As set out in The Scottish Government's response to the recommendations of the Commission on Scottish Devolution they would still result in 80% of Scottish tax revenue being reserved to the UK Government. In addition, a number of risks to

the Scottish Government Budget have been identified with the proposal^{1,2,3}. In particular, it is possible that the Commission's proposals could expose the Scottish Budget to a significant degree of volatility, but would not provide the appropriate policy levers or administrative procedures to mitigate these effects.

Transport infrastructure

3.4. The Commission also recommended that the Scottish Government should be given greater autonomy to borrow to fund capital investment. In relation to transport infrastructure this additional borrowing capacity would provide the Scottish Government with greater flexibility over the pace and priorities of major transport investment projects. They would also bring the Scottish Government into line with other tiers of government in the UK including local authorities and the devolved administration in Northern Ireland, which have greater borrowing autonomy than are currently available to the Scottish Government. However, Scottish Ministers would only be able to borrow on a prudential basis from HM Treasury, through the National Loans Fund or the Public Works Loan Board. The Scottish Government would also be unable to borrow to offset cyclical fluctuations in tax receipts, or to provide a fiscal stimulus at a time of economic need. The Treasury would therefore retain the ability to set conditions and cap the amount of borrowing. Substantive constraints would therefore remain on the Scottish Government's ability to effectively manage its finances and capital investment programme. It is estimated that every £100 million borrowed for infrastructure investment in Scotland could support 1,500 jobs in a period of suppressed demand in the construction sector. The ability to borrow is therefore of great importance to Scotland as we emerge from the recession but still face the challenge of growing unemployment.

3.5. Chapter 3D of the Commission's report also set out the rationale for the Air Passenger Duty (APD) element of recommendation 3.2:

Stamp Duty, Land Tax, Aggregates Levy, Landfill Tax and Air Passenger Duty should be devolved to the Scottish Parliament with a corresponding reduction in the block grant.

Air Passenger Duty (APD) is an excise duty which is charged on the carriage, from a UK airport, of chargeable passengers on chargeable aircraft. It is paid by the aircraft operator. Presently, there are four rates of duty, depending on the destination of the flight and the class of travel ranging from £10 to £80 per passenger... with destinations categorised on the distance from London to the capital city of the destination country or territory. APD is not payable on flights departing from airports in the Scottish Highlands and Islands. Assuming the devolution, and thus the potential application of different rates in Scotland than elsewhere in the UK, did not conflict with EU law, we think the devolution of APD would not be associated with administrative or economic inefficiencies and is therefore potentially achievable.

3.6. This is potentially a very positive development although the creation of a devolved framework for these taxes would not be straightforward. If implemented by the UK Government this would provide the Scottish Government with the ability to reform the tax to better reflect the Scottish Government's core objective of sustainable economic growth. For example, reducing the rate of duty would lower the cost of air travel from Scotland and would

¹ Cuthbert, J.R., Cuthbert, M.: "Open Letter to the Commission on Scottish Devolution: Technical Failings in the Calman Proposals on Income Tax": open letter sent to Commission on Scottish Devolution secretariat, 16th July 2009.

² 'Long-term planning is threatened by report' – <http://thescotzman.scotsman.com/opinion/Longterm-planning-is-threatened-by.5371689.jp>

³ 'Calman panel member warns of 'disastrous' tax changes' - <http://news.scotsman.com/latestnews/Calman-panel-member-warns-of.5386447.jp>

provide an incentive for airlines to retain and expand international air links. This could help reduce the need to undertake air travel connections within the UK and would help support Scottish importers and exporters, the Scottish tourist industry and the economy more widely.

3.7. In terms of more general support for business and enterprise in Scotland, the Commission's report featured recommendations on two issues: employment policy and industrial relations including health and safety and migration policy; and trade and commerce. Details of the recommendations and an analysis of the implications for business in Scotland are set out in order in the following sub-sections:

Employment policy and industry relations

3.8. Chapter 5D of the Commission's report is predicated on the view that Scotland derives considerable benefits from being part of a wider economic and social Union. The viability of this economic union is dependent on the free flow of capital, goods and labour throughout the UK. The Commission therefore did not recommend changes to the current reservation of employment and industrial relations.

3.9. The Commission did, however, consider in greater detail the issues of health and safety and migration policy in so far as this concerns the labour market, recommending that:

In recognition of the close interaction of the HSE's reserved functions with areas of devolved policy, a closer relationship between the HSE in Scotland and the Scottish Parliament should be developed.

The Commission recognised that there is no reason in principle why health and safety (or elements of enforcement) could not be devolved. Nevertheless, the Commission questions whether this would appreciably improve matters for the people of Scotland. The Scottish Government believes there is no reason in principle not to devolve health and safety. This would enable the development of a health and safety regime most suited to Scottish workplaces and business needs.

Whilst retaining the current reservation of immigration, active consideration (supported by inter-governmental machinery) should be given to agreeing sustainable local variations to reflect the particular skills and demographic needs of Scotland.

The Commission's rationale for this was that the nature of the UK and the freedom of movement and employability that its citizens enjoy mean that changes in the law in one part of the UK could have a significant and unintended impact elsewhere.

However the majority of submissions the Commission received on this issue called for greater flexibility and more responsibility for the Scottish Parliament and Government within an overall UK framework on immigration. A sub-Nation State migration policy has been established successfully in a number of countries, including Australia and Canada. The Scottish Government's view is that the proposal is little more than a variation on existing arrangements and that the Scottish Parliament should have more immigration powers. We question whether it is right to forego more substantive benefits for Scotland - in terms of potential access to key skills which will underpin economic and social growth - in order to give greater priority to the needs of other parts of the UK. Equally, devolving responsibility for immigration need not necessarily have a negative impact on the rest of the UK as suggested by the Commission, as experience elsewhere shows.

3.10. The free flow of capital, goods and labour throughout the UK is not dependent on the viability of the political union that is the United Kingdom. As a committed member of the European Union, the free flow of goods, services and people would continue to exist, just as it currently does between Scotland and other Member States, such as Ireland.

Trade and commerce

3.11. Chapter 5M of the Commission's report is predicated on the view that Scotland benefits from being part of a wider economic entity, contributing to and sharing in the benefits in times of prosperity and pooling resources and risk in times of financial uncertainty. The Commission considered that the effective operation of the UK as a successful, modern economy is underpinned by a complex set of laws relating to business associations, financial services and consumer protection. As such the Commission did not recommend any alteration to the reservation of company law, competition policy, financial services regulation and consumer protection which it considers are vital safeguards for the single market and wider economic Union. The sole recommendation - which the Scottish Government does not accept⁴ - relates to the technicalities of corporate insolvency.

3.12. The Scottish Government remains firmly committed to Scotland's continuing, and indeed enhanced, inter-connectedness with wider UK, European and global markets. This outcome is not dependent on the existing set of constitutional arrangements within the UK. Indeed, the current arrangements have, for many years, failed to enable Scotland to match the economic performance of the UK as a whole. The Commission appears to have failed to consider alternative models, which would enable Scotland's business community to fare better in international trade and to act within a regulatory and competitive environment which suits their needs rather than that of the UK as a whole.

3.13. Notwithstanding the positive working relations between the Scottish Government and the main economic regulators, there remains scope for closer working based on, and drawing out, the connections between economic regulation and the economic development functions which are already devolved to the Scottish Parliament. The distinctive nature of energy, transport, telecommunications and financial services markets in Scotland are not only important in their own right, but have much wider implications for Scottish business. For example, the market for banking services is now even more sharply distinct in Scotland than elsewhere in the UK. Given the importance of an effective supply of finance to Scottish businesses, it is increasingly important to ensure that the distinctive Scottish issues are addressed by regulators in the UK. Overall, there is an opportunity – indeed an imperative – to ensure that policies toward business in Scotland are designed to meet Scottish circumstances and to aid businesses based in Scotland to compete internationally.

3.14. When viewed strategically, or in the context of the current global economic downturn and the actions being taken by the European Union and governments around the world to review financial regulation and to promote economic recovery, it is clear that the Commission delivers little - if any - substantive benefit for the business community in Scotland. It provides no new tools or policy levers which would help the Scottish Government support business and enterprise. It preserves the status quo, leaving the UK Government with the capacity to prioritise UK interests over Scottish interests in relation to economic and business development and support.

3.15. In essence, therefore, the Scottish Government view is that the Commission has failed to recognise or address the comparative under-performance of the Scottish economy within the UK. In so doing it has failed to consider the full range of policies which could

⁴ The Scottish Government Response to the Recommendations of the Commission on Scottish Devolution (Recommendation 5.23, Page 26) October 2009.

improve Scotland's long-term competitiveness. It has therefore missed a major opportunity to align policies with the distinctive needs and ambition of Scottish businesses and with the overarching economic purpose of the Scottish Government. The Commission effectively sustains the conditions which have underpinned lower economic growth in Scotland compared to the UK as a whole.

4 Enhancing and maximising devolution

Chapter Summary

- The Scottish Government is keen to examine how the existing devolution model might be enhanced to include full fiscal autonomy and the transfer of a range of other responsibilities vested in the UK Government - and believes doing so would provide real business benefits for Scotland.
- The Scottish Government is committed to making Scotland one of the best places to do business in Europe, by for example reducing the rate of corporation tax to significantly below the UK level.
- However, under any enhanced devolution model, a range of rules and commitments imposed by the UK would continue to constrain the policy levers available to the Scottish Government, thereby sustaining factors which have historically impaired Scotland's growth performance and competitiveness.

4.1. The concept of “devolution max” was defined in “Fiscal Autonomy in Scotland: The case for change and options for reform” as full fiscal autonomy within the UK, making the Scottish Parliament and Scottish Government responsible for raising, collecting and administering all (or the vast majority of) revenues in Scotland and the vast majority of spending for Scotland. This option broadly reflects the system in Spain for the Basque Country and Navarre where the autonomous communities have responsibility for raising and collecting all direct taxes, including corporation tax. However to conform to EU legislation and retain a largely harmonised social security system, indirect taxes and payroll taxes remain centralised. In addition, the Basque and Navarre Governments pay a contribution to Madrid (the 'cupo') for centralised services such as defence and foreign affairs. The two areas have used their greater autonomy to put forward distinct policy solutions, including creating a more competitive tax regime relative to the rest of Spain.

4.2. While this represents the maximum form of fiscal and policy devolution short of an independent Scotland, several factors would continue to constrain fiscal policy:

- Intra-national rules and guidelines – notably EU laws governing taxation policy both between and within Member States (including EU State Aid Laws). For example, EU directives on harmonisation of sales taxes would require that Scotland did not diverge from UK VAT policy (including rates, allowances and derogations).
- Rules/agreements with UK Government - even with apparently full fiscal autonomy a range of rules and commitments are likely to constrain the Scottish Government, limiting Scotland's ability to pursue a fiscal policy that was significantly different from elsewhere in the UK.

4.3. In addition, unless specifically negotiated, key aspects of economic policy would remain reserved. For example, financial regulation, employment and competition law would be likely to remain centralised at the UK level.

4.4. However, the major potential benefits associated with the devolution max option - in a business and enterprise context - relate to the capacity that the Scottish Government

4 Enhancing and maximising devolution

would have to take account of Scotland's needs and ambitions and act accordingly in relation to key areas of fiscal policy, by for example introducing a more appropriate rate of corporation tax.

4.5. Alongside other important economic policy levers, competitive corporation tax rates have been used by many countries as a means of fostering economic growth. Many organisations have argued for a more competitive corporation tax system to be introduced in the UK. For example, politicians and business leaders in Northern Ireland have repeatedly called for the country's corporation tax rate to be cut to bring it in line with the Republic of Ireland. The Economic Research Institute of Northern Ireland estimate that the boost to investment, competitiveness and productivity such a policy could provide, may double Northern Ireland's growth rate over the long term and create over 180,000 jobs⁵. The GES makes clear that the Scottish Government believes in making the "case for Scotland to have fuller, and eventually full, responsibility for tax raising and public spending, utilising this to make Scotland the lowest taxed part of the UK, dropping corporation tax significantly below the UK level."

Box 2: Corporation Tax in the Basque Country

The Basque Country enjoys considerable fiscal autonomy, with wide ranging responsibilities over the collection of tax receipts and government expenditure, while remaining part of Spain. Its GDP per capita is approximately 30% higher than the Spanish average, and at the start of 2009 the Basque Country Government enjoyed a higher credit rating than the Spanish Federal Government.

The fiscal relationship between Spain and the Basque Country is governed by the *Concierto Económico*, or Economic Agreement consistent with the Statute of Autonomy (1977). Under this agreement, the Basque Country Government has the authority to vary most forms of direct taxation including income tax, corporation tax and taxation on wealth and capital gains and has introduced a headline corporation tax rate of 32.5%, compared to the Spanish rate of 35%. However, the Economic Agreement also contains a number of general principles which are designed to ensure a degree of harmonisation between the Basque tax system and that in the rest of Spain. Constraints therefore remain on the policy levers available to the Basque government. This serves to limit the degree of effective autonomy.

The Basque Country Government is responsible for collecting and managing all corporate tax revenues raised within the Basque Country. Companies operating in both the Basque Country and the rest of Spain are liable to corporation tax from both. Cooperation between the Spanish and Basque governments' ensures measures are in place to reduce the administrative burden.

4.6. Whilst the UK's statutory rate of corporation tax is comparable to the other G7 economies, a number of European countries of comparable size to Scotland have introduced significantly more competitive rates.

4.7. There is also evidence to suggest that there can be economic benefits from lowering corporation tax burdens on businesses. In particular, a competitive tax structure can be a positive factor in boosting private sector investment, capital formation, R&D and economic

⁵ Greenaway D., Gorg H., and Barry F., 2006, "Assessing the Case for a Differential Rate of Corporation Tax in Northern Ireland", Economic Research Institute of Northern Ireland, November 2006.

growth. It can also encourage greater foreign direct investment (FDI) and make regions and countries more attractive for the location of headquarters and other corporate activities. These effects can be large, with many academic studies reporting that taxation is a significant determinant of economic growth. Such a policy for Scotland has been advocated by a number of economists, including Hallwood and MacDonald (2006)⁶.

4.8. In addition to cutting the headline rate of corporation tax, a number of other options for reform are possible. These include adjusting the tax rate for small and medium sized companies, providing greater allowances for particular activities and simplifying the administrative process.

Box 3: Corporation Tax

As highlighted in the Government Economic Strategy, the Scottish Government is committed to making Scotland the lowest taxed part of the UK. Within the current fiscal framework, the Scottish Government has introduced the Small Business Bonus Scheme to reduce the burden on the small companies which form the majority of Scotland's business base. It has abolished all bridge tolls in Scotland to promote fairness and equity, to support business and communities and to promote sustainable economic growth.

In contrast, responsibility for corporation tax is reserved to the UK Government. In comparison to other countries, the UK (and hence Scotland) has a relatively high main corporation tax rate. This places companies in Scotland at a competitive disadvantage. Companies operating in Scotland face the eighth highest corporation rate in the EU

While corporation tax is only one element of overall competitiveness, greater devolution provides opportunities to enhance Scotland's competitiveness. Implementing the devolution max model could result in the responsibility for setting and collecting the vast majority of tax revenue in Scotland being devolved to the Scottish Parliament. This could provide an opportunity for the Scottish Government to reform the corporation tax system.

4.9. The Scottish Government is - and will remain - determined to explore all possible options for reforming corporation tax in the context of the "devolution max" model. Potentially these provide an important stimulus for investment, innovation, trade, productivity and business competitiveness. That could, in turn, have a hugely positive impact on the capacity of businesses to grow and internationalise, driving the faster and sustainable economic growth which is this Government's Economic Purpose. However, under devolution max, a range of rules and commitments may continue to impose constraints on the policy levers available to the Scottish Government. Therefore limitations would remain on the ability of the Scottish Government to introduce a corporation tax system which was significantly more competitive than elsewhere in the UK.

4.10. Subject to negotiation with the UK Government, enhanced devolution might also include other elements of the tax system, for example those taxes directly linked to transport. At present fuel duty, air passenger duty and vehicle excise duty, are all reserved to the UK Government. These taxes account for just 5% of Scottish tax revenue in 2007/08. However they are potentially important policy instruments which can have a significant impact on the behaviour of individuals and enterprises, and for achieving economic objectives.

⁶ MacDonald R., and Hallwood P., 2006, "The Economic Case for Fiscal Autonomy", Policy Institute, Edinburgh.

Fuel Duties (including domestic fuel)	2,074
Air Passenger Duty	164
Vehicle Excise Duty	425
Total	2,663
Source: Government Expenditure and Revenue Scotland (GERS) 2007-08	

4.11. Enhanced devolution could, for example, include greater autonomy over fuel duty, enabling the Scottish Government to apply to the EU for derogation for a lower rate of fuel duty in rural areas to address accessibility and price disadvantages faced by Scotland's remote and island communities. A similar system has been introduced in France and has allowed the French government to introduce a lower rate of duty in Corsica. The benefits of introducing fuel derogation were also recognised by the Commission on Scottish Devolution which stated that there was a case for the Scottish and UK Government's "to co-operate and pursue a derogation limited to the outlying parts of the Highlands and Islands".⁷ However, although the Scottish Government has written to the UK Government on numerous occasions requesting that they apply for fuel derogation for rural areas the requests have been turned down.

4.12. In addition to exploring the options available within fiscal autonomy, The Scottish Government is willing to examine how the base devolution max model might be enhanced and is confident that doing so would provide real business benefits for Scotland. For example, as mentioned earlier, health and safety policy and regulation is at present a matter reserved to the UK Parliament but delivered in Scotland through both the existing UK Health and Safety Executive (HSE) and local authority Environmental Health Officers (EHOs). If health and safety was included in an enhanced devolution max model there would be greater scope to move from an "enforcing" to an "enabling" regulatory approach, which could:

- Provide better clarity to employers on responsibility for enforcement,
- Remove boundaries for responsibility and avoid gaps in coverage for enforcement; and
- Improve consistency.

4.13. This approach would also promote the development of a health and safety regime for Scotland that is based on the Scottish Government's established commitment to build on and expand comparative advantage through the application of the key principles of better regulation: targeting; transparency; consistency; accountability; and proportionality. This would support - rather than impede business competitiveness and economic growth by reflecting the needs of employers and employees in Scotland.

⁷ Serving Scotland Better: Scotland and the United Kingdom in the 21st Century – Pg 98

5 Independence

Chapter Summary

- Only independence allows Scotland the freedom to use the full levers of government to create a more successful country, with opportunities for all of Scotland to flourish, through increasing sustainable economic growth.
- Business and enterprise benefits would emerge from outcome-focused reform of, for example: fiscal and tax policy and collection arrangements; competition and consumer policy; financial services regulation; promotion of international trade; skills and immigration; and transport infrastructure.
- The rest of the UK would remain our closest partner and ally and an independent Scotland would clearly seek to focus policy to enhance trading and other economic opportunities within the British Isles.

5.1. The Scottish Government's considered position is clear. Only independence allows Scotland the freedom to use the full responsibilities of government to *create a more successful country, with opportunities for all of Scotland to flourish, through increasing sustainable economic growth.*

5.2. In practice, of course, under independence a range of policy issues would be subject to European and international rules and regulations, such as EU directives on competition, tax harmonisation and the EU Single Market. However, unlike the other options outlined above, Scotland's relationship with the international economic, financial and business community would be set firmly in the context of Scotland acting as an independent sovereign state. Scotland would therefore have the ability to shape and influence policy at the local, national and international level in a way that is currently not possible. Only independence provides Scotland with a full voice in Europe and the capacity to make policy and fiscal choices which address the factors which have contributed to the economic under-performance of the last 30 years and the associated social implications.

5.3. Earlier National Conversations documents have already set out in more detail the options and impact relating to fiscal autonomy, foreign affairs etc. The remainder of this document provides an illustration of some of the choices and options that would be available to a future Scottish Government which could better promote increased sustainable growth by pursuing distinctive policies in addition to those outlined in the enhanced devolution chapter. These examples are provided in relation to:

- Tax collection
- Competition and consumers
- Financial services
- International trade
- Skills and immigration
- Transport infrastructure

Tax Collection

5.4. Paying taxes is an important cost factor for businesses and a simplified process is often cited as an objective of reform. An independent Scottish Government would be able to establish a payments system designed for the Scottish economy and Scottish businesses.

Box 4: Tax Collection

Although the statutory rate of business tax is an important element of the overall competitiveness of a country's tax system, the costs of compliance and the administrative burden imposed by the tax system are also important. For example, corporate taxes are inherently complex and a considerable amount of resources are typically diverted both by the taxpayer (the private sector) and the tax collector (the public sector) to meet the administrative burden. In a study commissioned by HMRC in 2006, KPMG estimated that the administrative burden imposed by corporation tax on businesses was £608 million, 70% of which fell on SMEs⁸. The complexity of the UK tax system was also highlighted as an important issue for the UK by the CBI in its recent report on reforming business taxation⁹.

Simplifying the tax system and increasing transparency reduces costs for businesses and government. It can also reduce incentives for tax avoidance and non-compliance, thereby reducing monitoring costs and potentially increasing revenue. However, under the current fiscal framework, the Scottish Government is unable to introduce reforms which could streamline the tax system. The Commission on Scottish Devolution also chose not to recommend devolving responsibility for the corporation tax system to the Scottish Parliament.

Under full fiscal autonomy in an independent Scotland, the Scottish Government would be responsible for the administration and collection of all taxes. This would provide an opportunity to ultimately put in place a simpler and more transparent tax system. International evidence¹⁰ confirms that small countries can administer their tax systems efficiently and effectively: the UK employed nearly 90,000 people to administer its tax system in 2007, while Norway and Finland both managed with just 6,000 staff; the UK spent nearly twice as much as Norway, and almost two thirds more than Finland, on tax administration (as a proportion of GDP) in 2007. The Scottish Government is open to exploring all possible options. One option would be to focus on simplifying the payment system, such as by streamlining company returns. In addition, new rules could be put in place for the smallest companies, such as assessing tax liabilities on cash flow rather than accounting profits¹¹, if this was seen to provide a benefit. A key lesson from recent years has also been the need to engage and consult with business prior to any significant tax reform. The uncertainty and negative effects of recent announcements on capital gains tax is a visible demonstration of this point.

One generic element of reform would therefore be to involve business leaders directly in the design of revised tax, regulation and enterprise systems for Scotland. This could provide an opportunity to introduce reforms which reduced the compliance costs faced by companies and the cost to the public sector of administering the system, while still delivering sustainable economic growth and wider benefits for Scotland as a whole.

⁸ KPMG (2006) - Administrative Burdens – HMRC Measurement Project Report by Tax Area Part 7: Corporation Tax

⁹ CBI (2008), "UK Business Tax: A Compelling Case for Change", CBI, March 2008

¹⁰ OECD - Tax Administration in OECD Countries and Selected Non-OECD Countries

¹¹ HMRC and HMT are currently consulting on such issues.

Competition and consumers

5.5. In simple terms, markets are a mechanism for capturing gains from trade and specialisation. Well-regulated, competitive markets can promote and sustain economic growth where firms strive to gain an edge on rivals by for example improving their products and services or minimising costs.

5.6. Competition therefore provides strong incentives for firms to be more efficient and innovative, helping to raise productivity growth across the economy. When markets work well, businesses also thrive by providing what consumers - whether domestic or international - want better and more cost-effectively than their competitors. Effective competition therefore provides significant benefits for consumers through greater choice, lower prices, and better quality goods and services. Left to their own devices, however, markets will not always deliver the best outcomes for consumers, companies or nations. Therefore governments develop legal, institutional and operational frameworks which aim to influence and direct the appropriate conduct of firms and individuals. Markets do not exist independently of Government, which has a legitimate regulatory role. In an independent Scotland the focus of Government would be on securing or sustaining comparative advantage.

5.7. At present both competition and consumer matters are reserved to the UK Parliament by Schedule 5 to the Scotland Act 1998, with the UK Office of Fair Trading (OFT) enforcing a range of complex legislation including the Competition Act 1998, the Consumer Credit Act 1974 and the Consumer Protection from Unfair Trading Regulations 2008. Independence would allow future developments in competition and consumer policy to be based on Scottish political, social and economic interests rather than those of the UK.

5.8. The business community in Scotland contrasts significantly with the rest of the UK. Authority over competition in Scottish markets, combined with full fiscal autonomy designed to make Scotland a more attractive place for doing business, would drive general and sector-specific productivity and growth benefits in terms of:

- encouraging businesses to improve their internal efficiency and reduce costs;
- incentivising early adoption of new technology and other forms of innovation;
- increasing the international competitiveness of Scottish businesses and products.

Box 5: Using Air Passenger Duty to improve Scotland's competitiveness

The Scottish Government has no responsibility for Air Passenger Duty (APD) at present. Under independence, Scotland would have the ability to amend or remove the tax to fully reflect the Scottish Government's priorities and objectives. This would also create incentives for businesses and for consumers.

Adjusting the rate of air passenger duty in Scotland would provide an incentive for airlines to retain and develop Scotland's international air links. This would help reduce the need for Scottish residents to undertake air travel connections within the UK and would help support Scottish business, the Scottish tourism industry and the economy more widely.

5.9. There is a body of evidence that policies designed to support effective competition can stimulate economic growth and business competitiveness. There are however some data limitations in analysing the degree of competition within Scottish markets. A recent

paper¹² prepared by the Policy Institute has however noted that “there is some evidence of a lack of competition in markets in Scotland, with prices high relative to the UK in areas like transport, utilities, catering and leisure services”. A critical mass of informed and demanding consumers can support and encourage innovation and higher productivity.

5.10. Consumers in Scotland would also benefit from regulation which is more closely aligned with their diverse needs and interests.

Box 6: Extract from Consumer Focus Scotland’s response to “Choosing Scotland’s Future; A National Conversation” (March 2009)

There are particular aspects of Scottish geography and the attitudes of consumers in Scotland that must be recognised and accounted for in order to achieve equity for Scottish consumers. For example, a far higher proportion of Scotland is rural than the rest of the UK, whilst the specific needs and interests of island residents is a particular consideration in Scotland. Scottish consumers who live in areas which are remote from urban centres often, for instance, enjoy far fewer choices in the products and services that they use – particularly in markets such as energy, retail and telecommunications.

5.11. Consumer policy in an independent Scotland could therefore be developed in the context of a set of key principles or considerations such as: access; choice; safety; information; fairness; representation; redress; and education. This would help deliver a consistent yet flexible approach to thinking about the needs of consumers across different markets, increasing the likelihood of producing real consumer benefits and increased business opportunities.

Financial services

5.12. Financial regulation is one example of the wider benefits of independence likely to derive from the necessity to focus for the first time on Scotland’s distinctive context, needs and aspirations across the full range of regulatory responsibilities in order to deliver opportunities for all of Scotland to flourish, through increasing sustainable economic growth. It is sometimes necessary to underpin an efficiently functioning market to ensure investor protection and to maintain financial stability. As we have seen from recent global events, the impact of financial instability in the real economy can be significant in terms of jobs and investment - with Government intervention also leading to significant strain on public sector finances.

5.13. We now recognise that regulators in national jurisdictions across the world had introduced processes designed narrowly to regulate individual institutions within the different sectors of the industry. In the UK, there was an inadequate development of regulatory mechanisms to address the wider systemic risks, which ultimately led to the crisis which spread through the banking sector, and outside of the financial industry to the real economy. Adair Turner, Chairman of the Financial Services Authority has set out quite clearly that bankers, policymakers and regulators alike were profoundly wrong in their assumptions in the years leading up to the crisis that market discipline was effective.¹³

¹² <http://policyinstitute.info/research-publications/economy/the-key-to-economic-success-in-scotland>

¹³ Address to the British Bankers’ Association Annual International Banking Conference 30 June 2009

http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2009/0630_at.shtml

5.14. It is clear, therefore, that although the importance of the financial system to national economies means that financial regulation will remain primarily a national issue - international and European rules are increasingly becoming more important in order to ensure a global response to the current financial crisis and the development of systems to help identify and mitigate these types of risk in the future. It is vital that Scotland is in a position to influence the development of measures to regulate systemic risk in the financial services sector, taking into account the continuing, and welcome, presence of major banks and wider financial services sector in Scotland.

5.15. At present the regulation of financial services is a matter reserved to the UK Parliament by Schedule 5 to the Scotland Act 1998. HM Treasury is the United Kingdom's economics and finance ministry. It is responsible for formulating and implementing the UK Government's financial and economic policy. The Bank of England is the central bank of the United Kingdom. It has two core purposes:

- Monetary Stability - stable prices and confidence in the currency. Stable prices are defined by the Government's inflation target, which the Bank seeks to meet through the decisions delegated to the Monetary Policy Committee, implementing them effectively in the money markets.
- Financial Stability - entails detecting and reducing threats to the financial system as a whole. Such threats are detected through the Bank's surveillance and market intelligence functions. They are reduced by strengthening infrastructure, and by financial and other operations, including, in exceptional circumstances, by acting as the lender of last resort.

5.16. With independence the Scottish Government would judge the most appropriate mechanisms for financial services regulation. This could be done through partnership arrangements with the rest of the UK or following the model adopted by nations such as Ireland, which has its own financial regulator. The needs and interests of the wider economy, consumers and the financial sector itself would be key factors in determining the right approach.

5.17. The importance of financial regulation is significant in relation to the economic future of Scotland as well as the future success of our financial services industry. Importantly, the current global economic crisis has intensified the need for international co-operation on these matters, and policy decisions will need to take account of this.

5.18. In summary, an independent Scotland could determine the best approach to the development and regulation of financial services in Scotland, including making decisions on partnership arrangements with the rest of the UK and in this context which institution(s) should be involved in each of the main aspects of ensuring an efficiently functioning market, financial stability and consumer protection. This would provide opportunities to:

- create a unique Scottish financial services culture to ensure the success of the industry in the future
- ensure market and financial stability aspects meet the needs of the Scottish economy and fiscal policy
- maximise political accountability
- influence EU and international policy from a Scottish perspective
- promote Scotland as a distinct financial centre with a business friendly environment
- attract new institutions to the market.

International trade

5.19. Scotland is - and has long been – an outward looking trading nation, with strong global connections. The Government’s Economic Strategy places a strong emphasis on international activity, explicitly in the document, and indirectly as a means of delivering long-term growth targets for key sectors and the economy as a whole. The Scottish Government, and its agencies (primarily Scottish Development International), working with businesses, representative and civic organisations, colleges and universities, communities and friends of Scotland across the globe, are already actively working to:

- increase the internationalisation of Scottish companies;
- increase the flow of inward investment to Scotland; and
- promote Scotland internationally as the home of innovative businesses and a vibrant place to do business, work and live.

5.20. While that will continue, increasing the impact of the international sector of the Scottish economy is absolutely crucial in the context of any and all constitutional models.

5.21. The rest of the UK is our biggest trading partner, with “exports” estimated to be worth £26.1 billion in 2007. An independent Scotland would seek to enhance that relationship including developing new opportunities for Scottish business within these isles as well as more widely. Our common history and geography means that the nature of our relationship with the rest of the UK will develop. The UK will continue to be our closest partner and ally with independence bringing the relationship and partnership up to date. The key difference is that this would be an equal partnership. For example, as a full partner in the EU with full voting rights Scotland would want to work closely with the rest of the UK to ensure that common interests were reflected more accurately in EU decision making.

5.22. Independence would of course also provide Scotland with substantive opportunities to enhance international trade through the development of relations with other countries based on Scottish political, social and economic interests. This would present opportunities for businesses, for trade, and for inward investment, underpinned by the capacity to take fiscal decisions which are in Scotland’s best interests. As set out in *Europe and Foreign Affairs - A new and better way for Scotland*, Scottish foreign policy and its delivery would be dedicated to Scotland’s interests in a way which is not possible under current arrangements. Scotland’s international approach would be focused less on the projection of power and more on trade. It would seek to further develop relationships with the Scottish Diaspora and the creation of appropriate alliances.

5.23. In addition, of course, as a full member of the EU Scotland would continue to have access to that considerable market. Indeed, businesses in Scotland could secure a greater share of that international trade given the capacity of an independent Scottish Government to use expanded responsibilities over economic growth to better support their interests and competitiveness. The European Union provides a market for Scottish exports, and guarantees fairness and non discrimination for Scottish businesses in EU markets. Where such markets are highly regulated (such as energy, telecoms and financial services), an independent Scotland could work closely with regulatory bodies in other countries to ensure that the objectives of the EU single market were met. The Scottish Government could put mechanisms in place to ensure cross border co-operation and trade and investment, while removing some of the barriers which have hindered development of Scottish industry in the past.

5.24. Full fiscal autonomy would enable the Scottish Government to pursue a more integrated and focused range of policies designed to make Scotland a more attractive place for doing business.

Skills and immigration

5.25. The Government's Economic Strategy recognised that Scotland has real strength in the most vital factor for modern economies - the human capital offered by our greatest asset, Scotland's people. It recognised the need to build on and sustain that comparative advantage in the global economy. It also makes clear that labour productivity is behind the UK average and significantly behind the levels in the US and our competitors in the more advanced European countries.

5.26. Looking ahead, demographic change will be a key determinant of Scotland's long term economic performance. Scotland faces two principal challenges in relation to population.

5.27. The first challenge concerns the *size* of the population. Population growth – and in particular growth of the working age population – is a key driver of economic growth performance. In recognition of this challenge, the Scottish Government has established an ambitious population growth target to *match average European (EU-15) population growth over the period from 2007 to 2017*¹⁴.

5.28. The second challenge concerns the potential long-term impacts on the Scottish economy that will result from projected changes in the *structure* of the Scottish population. Over the longer term, Scotland along with the rest of the UK and other western nations looks set to experience a significant demographic shift, which will result in: an increase in the average age of the Scottish population; a decreasing working age population; and an increase in the ratio of persons of pensionable age to persons of working age¹⁵.

5.29. The GES outlines, within the responsibilities and levers that we currently have, the policies the Scottish Government is putting in place to best meet these challenges. An independent Scottish Government could do more.

5.30. For example, as signalled in *Europe and Foreign Affairs - A new and better way for Scotland*, independence would provide Scotland with substantive opportunities to pursue policies based on Scottish political, social and economic interests. As such, immigration policy could be tailored to address some of the economic challenges that may emerge as a result of demographic change, and to encourage more migrants to move to Scotland in order to stimulate population – and economic - growth. Immigration flows could also help address skills shortages in the labour market, and, in particular, shortages that were unique to Scotland.

5.31. An independent Scotland would manage immigration effectively to meet our own economic, social and demographic priorities and needs. An independent Scotland would be better placed to create the conditions for talented people to live, learn, visit, work and remain in Scotland.

¹⁴ *Government Economic Strategy*, Scottish Government (2007)

¹⁵ For example, in 2007 there were 314 persons of pensionable age to 1,000 persons of working. This ratio is projected to increase to 399 by 2031. Source: General Register Office of Scotland (GROS).

Transport infrastructure

5.32. The current devolution settlement provides no authority for the Scottish Parliament to sanction meaningful borrowing by the Scottish Government. Given that the Scottish Government is responsible for providing most public services in Scotland and significant infrastructure projects, such as investment in roads, schools and hospitals, this situation is a clear anomaly. In an independent Scotland, responsibility for managing public sector borrowing would lie with the Scottish Government giving it the ability to borrow on financial markets subject to the normal market constraints faced by other governments.

5.33. The Scottish Government's views on borrowing autonomy were set out in a paper published earlier this year¹⁶.

5.34. In the context of transport infrastructure, a significant advantage of greater borrowing autonomy is that it would provide the Scottish Government with greater influence over the pace and priorities of Scotland's capital expenditure programme and provide an alternative source of financing for major infrastructure projects as and when required.

5.35. This would create further opportunities to address the clear infrastructure needs of Scotland more quickly, not least in enabling early progress with a wider range of critical projects. For example, by phasing funding for the new Forth Crossing, capital budgets would be freed to take forward a range of other projects at the same time as the bridge construction, bringing additional immediate and long-term economic benefits.

¹⁶ <http://www.scotland.gov.uk/Topics/a-national-conversation/calcommscotgov>

6 Conclusions

6.1. The Scottish Government's considered position is clear. Only independence allows Scotland the freedom to use the full remit of government to *create a more successful country, with opportunities for all of Scotland to flourish, through increasing sustainable economic growth*. Unlike other constitutional options Scotland would be an independent sovereign state with the capacity to shape and influence business and enterprise policy at the local, national and international level in a way that is currently not possible.

6.2. In moving forward, the Scottish Government would remain focused on fostering a supportive business environment and improving the competitiveness of businesses in Scotland. The aim would be to build on existing factors underpinning comparative business advantage. Improvements to the business environment would be focused on supporting innovation and entrepreneurship with a view to fostering improved growth and productivity in the Scottish economy.

How to participate in the National Conversation

6.3. We welcome on-going debate regarding the issues covered by this paper as part of our National Conversation. Comments on this paper and the related policy options can be made through the National Conversation website at **www.anationalconversation.com**. Responses can also be sent by post to:

Business Competitiveness Division
Business, Energy and Enterprise Directorate
Scottish Government
3rd Floor,
5 Atlantic Quay,
Broomielaw,
Glasgow, G2 8LU

6.4. You can also participate by attending National Conversation events. Details of these can be found on the National Conversation website.

For further copies of this report or for more information on the National Conversation please email joinin@anationalconversation.com or visit the National Conversation website at www.anationalconversation.com

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