**BALANCE OF COMPETENCES REVIEW**
**SCOTTISH GOVERNMENT RESPONSE**

# ECONOMIC AND MONETARY POLICY

1. The Scottish Government welcomes the opportunity to contribute to this call for evidence. This response sets out the key areas where the Scottish Government wishes to make a contribution to the debate on the balance of competences between the UK and the EU in the area of economic and monetary policy. The response recognises the constraints that are placed on the Scottish Government's position on economic and monetary policy as a consequence of the current constitutional arrangements in the UK. Accordingly, the views expressed are set within the context of these existing arrangements.

## Background

### Scotland's Economy

2. Scotland is, by international standards, a wealthy and productive country and performs strongly in comparison with other parts, as well as the whole, of the UK:

- In terms of GDP per capita, Scotland was positioned as the third highest nation or region in the UK in 2012;[1] and with an illustrative geographic share of North Sea Output it is estimated that Scotland would be ranked 14th in terms of GDP per capita in the OECD in 2012.[2]
- Productivity, measured by output per hour worked, is 101.4% of the UK figure.[3]
- Scotland's employment rate of 73.4% (for the population aged 16-64) in February-April 2014 was higher than the UK rate (of 72.9%).[4]

### Division of Competences

3. Any assessment of competence in relation to economic and monetary policy must also consider the division of competences among the Scottish Government, the UK Government and the EU. Within the UK, despite the Scotland Act 2012 expanding the competence of the Scottish Parliament in this area, economic and monetary policy as regards Scotland is predominantly reserved to the UK Government.

4. The Scottish Government has its own economic strategy to deliver on the Scottish Government's Purpose "*to focus the Government and public services on creating a more*

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[1] ONS Regional Gross Value Added (Income Approach), December 2013 http://www.ons.gov.uk/ons/rel/regional-accounts/regional-gross-value-added--income-approach-/december-2013/stb-regional-gva-2012.html

2 Scottish Government (2014) *Scotland's International GDP Per Capita Ranking* http://www.scotland.gov.uk/Resource/0044/00446013.pdf

3 Scottish National Accounts Project (SNAP) *Labour Productivity: Initial Estimates of output per hour worked* http://www.scotland.gov.uk/Topics/Statistics/Browse/Economy/SNAP/Productivity/PROD12

[4] ONS Labour Market Statistics, June 2014

*successful country, with opportunities for all of Scotland to flourish through sustainable economic growth*".[5] The Scottish Government seeks to work constructively with both the EU institutions and the UK Government so that the economic policy applying in Scotland achieves those aims.

**EU competence – monetary policy**

5. The UK has a distinct position with regards to economic and monetary policy within the EU. The UK has an opt-out from joining the euro and as a result of this the majority of monetary provisions and a key number of economic and fiscal provisions do not apply to the UK.

6. In an increasingly open global economy, trading conditions in other countries will have an important bearing on growth in both Scotland and the UK, both in the near term and over a longer time horizon. Whilst the UK accounts for over 60% of Scotland's overall exports, the EU is Scotland's principal international export market, and the success of the Euro area is in Scotland's interest.[6]

7. Membership of the EU provides a range of economic benefits, in particular through access to the Single Market, the largest trading area in the world, with over 500 million potential customers.

8. Policies to further economic and fiscal integration within the Euro area as part of the "Genuine Economic and Monetary Union" should strengthen the single currency. It is in the interests of Scotland, the UK and all EU member states to have a successful and stable single currency. The Scottish Government is, therefore, supportive of strong EU action and mechanisms with regard to the Euro area which promote and safeguard economic stability and growth which should serve to protect the entire European Union from future economic shocks.

Fiscal Framework

9. The EU Stability and Growth Pact (SGP) provides a framework for the coordination of national fiscal policies across the European Union. The SGP has two key rules for member states, that the deficit must not exceed 3% of GDP and public debt must not exceed 60% of GDP.

10. There are two 'arms' to the SGP – the preventive arm and the corrective arm. The preventive arm seeks to ensure that fiscal policy is conducted in a sustainable manner over the cycle, setting Medium Term Objectives (MTOs) specific to each member state

[5] Scottish Government (2011) *The Government Economic Strategy* http://www.scotland.gov.uk/Publications/2011/09/13091128/0

[6] 2012 Global Connections Survey http://www.scotland.gov.uk/Topics/Statistics/Browse/Economy/Exports/GCSIntroduction

as part of the European Semester. The corrective arm sets out the framework for countries to take action in the case of an excessive deficit.

11. As highlighted by the Fiscal Commission Working Group countries entered the Euro Area with quite different economic structures and fiscal balances.[7] The EU SGP did not act as an effective constraint on a member state's ability to run unsustainable fiscal policies.[8]

12. Any fiscal rules must act as an effective constraint on a member's ability to run unsustainable fiscal policies whilst enabling fiscal flexibility to pursue distinct policies and objectives within the commitment to fiscal responsibility. The introduction of the "six-pack" (five new regulations and one directive) in December 2011 and the "two-pack" in May 2013 has strengthened the SGP, in particular the fiscal surveillance and enforcement provisions.

13. Although the UK is subject to the SGP, it must only endeavour to avoid excessive deficits and is not subject to disciplinary measures if it fails to meet the conditions of the SGP.

14. The Scottish Government recognises that an effective fiscal framework is important for delivering sustainable economic growth. Fiscal rules promote fiscal discipline and help ensure that the public finances remain on a transparent and sustainable path.

15. At the same time there needs to be sufficient flexibility in fiscal policy to design country specific approaches and policies to respond to the challenges and opportunities faced by individual countries.

16. Under the current framework the Scottish Government is responsible for approximately 60% of public spending – covering areas such as education and skills, transport, planning and local economic development.

17. However Scotland has limited tax autonomy with responsibility restricted to local taxation (i.e. council tax and business rates), accounting for around 8% of taxes collected in Scotland.[9] The Scotland Act 2012 will provide a limited increase in tax powers – including a Land and Buildings Transaction Tax, to replace Stamp Duty Land Tax, and a Scottish Landfill Tax to replace the equivalent UK tax. From April 2016, a Scottish Rate of Income Tax (SRIT) will be introduced. After the financial provisions of the Scotland Act

[7] For example, despite there being an agreed commitment to have debt to GDP ratios no greater than 60%, Italy joined the Euro with a gross debt to GDP ratio of 113.1% whilst Belgium had a ratio of 113.6%.

[8] Fiscal Commission Working Group (November 2013) *Fiscal Rules and Fiscal Commissions* http://www.scotland.gov.uk/Publications/2013/11/4732

[9] Government Expenditure and Revenue Scotland 2012-13 http://www.scotland.gov.uk/Resource/0044/00446179.pdf

2012 are fully implemented, the Scottish Government will be responsible for approximately 18% of onshore revenue and 16% of total revenue raised in Scotland.

18. The Scottish Government is committed to fiscal responsibility and recently announced the creation of a Scottish Fiscal Commission to scrutinise Scottish Government tax revenue forecasts for the taxes devolved by the Scotland Act 2012.[10]

19. The Scottish Government believes that independence would create the opportunity for Scotland to pursue a more productive, resilient and fairer economic model with sustainable economic growth.

**EU competence – economic policy**

20. Europe 2020 is the European Union's strategy for delivering smart, sustainable and inclusive growth over the period to 2020. The strategy has five key targets, relating to employment, education, research and innovation, social inclusion and poverty reduction, and climate change/energy. Europe 2020 also establishes seven 'flagship initiatives', which provide a framework through which the EU and national authorities mutually reinforce their efforts in areas supporting the Europe 2020 priorities.

21. The Scottish Government is strongly supportive of the ambitions and priorities of Europe 2020, with a significant degree of commonality between the strategy and the Scottish Government's Government Economic Strategy.[11] Central to both is a focus on accelerating recovery and securing economic growth that is both environmentally and socially sustainable.

22. Alongside the common central focus, there are a number of key links between the GES and Europe 2020, including areas such as innovation, the digital economy, youth unemployment, the low carbon economy and poverty. For example, the Scottish Government welcomes the scale and ambition of Horizon 2020 (the EU's future research an innovation policy) and the GES is closely aligned with some of the key objectives in Horizon 2020. In addition, both Europe 2020, through the flagship initiative A Digital Agenda for Europe, and the GES identify the potential benefits for households and firms from the roll out of high-speed internet. Furthermore, both strategies are focussed on ensuring that the benefits of sustainable growth are widely shared and the most disadvantaged areas and people in society are provided with the opportunity to prosper.

23. As a central feature of the European Semester, the National Reform Programmes (NRPs) provide context on the macroeconomic environment, outline how Member States intend to meet the targets set out in Europe 2020 and how they will overcome obstacles to economic growth. The Scottish Government is committed to engaging positively with

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[10] http://news.scotland.gov.uk/News/Scottish-Fiscal-Commission-announced-c43.aspx

[11] Scottish Government (2011) *The Government Economic Strategy* http://www.scotland.gov.uk/Publications/2011/09/13091128/0

EU institutions to fully represent Scottish interests and highlighting particular Scottish strengths to European partners. With this in mind, the Scottish Government makes a full contribution to the development of the UK's NRPs.[12]

24. However, given the unique characteristics of Scotland, and the distinct approach to Europe 2020 ambitions being taking forward in Scotland within the UK, the Scottish Government also produces a Scotland-specific NRP. This approach, which has been welcomed by both stakeholders and the Commission, highlights Scotland's positive engagement with the European Union. It also showcases areas where actions taken in Scotland make an important contribution to delivering the priorities in Europe 2020.[13]

**Reform**

25. The Scottish Government considers that it is vital for the EU's competence in respect of economic and monetary policy to be exercised in a way which promotes sustainable economic growth and increases the EU's competitiveness on a global scale while also ensuring the EU's institutions are connected with its citizens. This means ensuring that the economic and monetary policy also delivers social objectives including tackling unemployment, promoting social inclusion, reducing poverty, protecting the environment and addressing climate change.

**Conclusions**

26. The Scottish Government is committed to supporting the delivery of the ambitions of Europe 2020. The vision set out in Europe 2020 for a Europe where economic growth is smarter, sustainable and equitable is a vision that Scotland shares and strongly supports.

27. Continuous membership of the EU and the increasingly integrated single market is central to Scotland's future and its continuing economic success. In particular the success and stability of the Euro area is in the interests of Scotland, the UK and all EU member states. The Scottish Government is, therefore, supportive of EU competence and action to strengthen the Euro area.

28. Scotland is committed to sound fiscal management and recognises that within a well-designed fiscal framework it is important to have the ability to use economic and fiscal levers to deal with country specific challenges and opportunities.

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[12] HM Government (2014) *Europe 2020: UK National Reform Programme 2014* https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/307375/PU1633_National_Reform_Programme_2014.pdf

[13] Scottish Government (2014) *Europe 2020: Scottish National Reform Programme 2014* http://www.scotland.gov.uk/Resource/0044/00449253.pdf