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Independence and Responsibility: the future of Scotland

Alex Salmond MSP
First Minister of Scotland

London School of Economics and Political Science

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It is an honour to be here at the London School of Economics this evening. The LSE has been at the heart of debates on economic and social policy on these islands ever since it was founded by George Bernard Shaw, Beatrice and Sydney Webb and others late in the 19th century.

I note that earlier this month, Beatrice Webb's journals were put online by the LSE library. They prove how often we repeat the mistakes of previous generations. In September 1931, she wrote that "we know now the depth of the delusion that the financial world have either the knowledge or goodwill to guard the safety of the country over whose pecuniary interests they preside." She also complained that the financial elite of her time had made "an appalling mess of their own business – involving their country in a loss of business and prestige."

PLUS CA CHANGE!

New eras also throw up new challenges, however. LSE is at the forefront of addressing these, too – for example you host the Grantham Research Centre for Climate Change and the Environment, headed by Lord Stern.

Lord Stern's Review into climate change made the point that action on climate change is fiscally responsible, as well as morally just – the costs of moving to a low carbon economy are much less than the costs of not doing so.

This is an argument which I will return to when setting out how an independent Scotland would play a leading role in efforts to tackle climate change.

The main purpose of my speech is to set out how Scotland is economically constrained by its current constitutional position, and to give Westminster “six of the best” – to outline six key economic opportunities to support growth and promote jobs that Scotland could seize when she becomes independent.

First, however, I want to talk about our policy response to the ongoing financial and economic crisis.

LSE is again an appropriate place to do this. It was central to debates about the response to the great depression in the 1930s, when Hayek argued strongly against Keynes, who was at Cambridge.

As someone who is very much in the Keynesian camp on this issue, I am perhaps speaking at the wrong institution tonight!

But there is something deeply counterproductive about the current UK Government’s obsession with austerity. As Keynes was once reported as saying, “when the facts change, I change my mind.” Perhaps the worst part of the Chancellor of the Exchequer’s decision-making has been his almost total inability to adapt to changed circumstances. It was never going to be practical to sustain a recovery on export-led growth once it became clear that the UK’s major export market, the Eurozone, was enduring momentous challenges of its own.

Indeed, the decision by Moody’s on Monday to put the UK’s credit rating on a “negative outlook” is a stark reminder that deficit reduction without economic growth is almost impossible to achieve – regardless of whether you ascribe to the Austrian school or the Cambridge school.

Point one of the analysis from Moody’s attributed their decision to “the increased uncertainty regarding the pace of fiscal consolidation in the UK due to materially weaker growth prospects over the next few years, with risks skewed to the downside.”

The Chancellor, in his response to the Moody’s report, seems to have managed to miss even point one.

Which is strange – partly because it is of such importance, and, after all, it was point one!

Moody's is of course a salutary reminder that even ratings agencies, which might be expected to trend towards Hayek rather than Keynes on deficit reduction, are aware of the perils of low growth.

This lack of growth has been reflected in today's UK unemployment figure of 2.7 million.

The Scottish Government is still deeply aware, as are many places in England and Wales, of the lasting damage done to communities by the mass unemployment of the 1980s. For that reason, we have done everything possible to support economic growth and to create opportunities – especially for our young people. One of the few glimmers of light in today's employment figures is that they show the first stabilisation in many quarters – albeit a minor one - for youth unemployment in Scotland.

We have a range of policies designed to underpin security in these difficult times. We have a guarantee of no compulsory redundancies in the public sector – which doesn't mean that there is no reduction in the workforce, but provides security for those who need it – a policy of a living wage of £7.30 an hour, and we have made a commitment to provide certain services which are not prioritised in other parts of the UK.

One of those, of course, is free tuition fees – in Scotland, we still see free education as an investment in our nation's future, rather than just a price to be borne by individuals.

We have also given a guarantee of a training place to all 16-19 year olds not in employment, education or training, in addition to providing 125,000 Modern Apprenticeships in Scotland over the next five years, every one of which is attached to employment.

These steps do not necessarily alter the headline youth unemployment figures, because these include (strangely) full time students looking for part time work, but they are designed to forestall the emergence of another lost generation.

Our policies boost families' spending power, and make it easier for them to plan their budgets – all of which helps to promote security and sustain confidence.

Undoubtedly the most economically dangerous part of the UK Government's plans is its slashing of capital spending in real terms by about a third over the next Spending Review period. And although the comparatively minor additional capital spending announced in the Autumn Budget Statement was welcome, over 70% of it will be delayed until after autumn 2013.

Despite the significant constraints placed on us at the last spending review, we are working to safeguard capital investment in Scotland – we have switched almost £750 million over the spending review period from revenue to capital spending. As a result, our capital investment will now rise in Scotland, over the next three years, but from a Treasury-set low baseline – and it will take time to come into effect. As part of this, our Scottish Futures Trust has set up a pipeline of Non-Profit Delivering projects with local authorities and NHS Scotland – directly encouraging investment in local schools and hospitals.

We are also encouraging private sector investment – for example by establishing the Scottish Investment Bank in 2010, maintaining the most supportive business tax environment anywhere in the UK, and supporting our development agencies to create an attractive climate for inward investment. But again, we are stifled by a lack of powers – for example, the ongoing failure of the UK banks to meet their Project Merlin targets for small businesses has done far far more harm to business investment than the Scottish Investment Bank could possibly undo.

By comparison, UK central government policy sometimes seems to be based, at worst, on a passive acceptance of the consequences of austerity – or at best, a hope that quantitative easing on its own by the Bank of England will come to the rescue.

The Bank of England has decided to extend its asset purchase scheme by a further £50 billion to support the economy. Let me be clear, the work of the Bank of England through this crisis has helped to protect the economy at this most difficult time.

However as Keynes indicated, using monetary policy alone can be like pushing on a string. Quantitative easing should only be one part of the response to economic difficulties – it requires genuine support from wider economic policy. And the half measures attached to the Chancellor's last Autumn Statement were clearly insufficient.

For example, despite quantitative easing, net lending continues to fall. As a result, business investment, as we know, remains 16% lower than pre-recession levels.

And within this, there are clear divergences between different types of company. Large companies, which can often bypass banks by accessing the markets directly, have benefited from the quantitative easing programme. In contrast, SMEs don't have that option and there remains a clear market failure that needs to be addressed.

Over the year to November 2011, net lending to SMEs fell by 6.1% on the back of a 2.2% fall the previous year.

SMEs are vital to the long term success of our economy. They are an essential source of innovation and will create many of the key job opportunities in the years ahead. There is therefore an urgent need for an effective mechanism from Government to boost lending to small businesses – something that should have happened four years ago.

Last time I was in London, delivering the Hugo Young lecture, I argued that an independent Scotland could be a beacon for progressive social opinion – indeed that devolved Scotland was already in many respects something of a beacon. We have far more discretion in social policy than in economic policy at present, of course. But I would argue that the actions that we have been able to take have already helped to mitigate the worst consequences of economic uncertainty. The recession in Scotland was shorter and shallower than in the rest of the UK a 5.9% downturn over 5 quarters rather than a 7.2% downturn over 6.

But with independence, we could do much more – and potentially become a beacon in progressive economic policy as well as social policy.

An independent Scotland would remain within a sterling zone, but would have control over fiscal policy.

Now, in recent weeks, sources close to George Osborne have apparently said that Scotland might be prevented from using the pound.

This is clearly nonsensical. No nation can stop another from using a fully tradeable currency. In addition an independent Scotland has title to part ownership of both the Bank of England and sterling.

But in addition to this, why would any sensible Minister want to stop Scotland from sharing a currency with the rest of the UK?

The rest of the UK would benefit from Scotland's continued membership of a sterling zone. Oil and gas production boosted the UK's balance of payments by £32 billion in 2010 - almost halving the UK's deficit – and Scotland's whisky exports are likely to contribute almost £4 billion in 2011. There is also another £20 billion or so of other Scottish exports.

Would any UK Government seriously want to do without the support that those sectors provide for sterling's value?

Our on-shore economy is approximately 8% of the UK's – broadly equivalent to the size of the entire UK financial sector- and even excluding our oil and gas output, we're the third richest part of the UK outside London and the South East.

Some people say a currency union could prevent an independent Scotland from using its fiscal powers. We would undoubtedly need to demonstrate fiscal responsibility – as any sensible nation does. But Scotland is easily prosperous enough to stand on its own two feet. Indeed, the Government Expenditure and Revenue Scotland report demonstrates that from 2005 to 2010, Scotland was in a stronger relative fiscal position than the UK by a total of £7.2 billion. Last weekend, a study by the independent Centre for Economics and Business Research confirmed that Scotland receives no net subsidy from the rest of the UK.

Scotland would therefore be able to meet any fiscal obligations of a currency union. In addition, Scotland and the rest of the UK are very similar economies in terms of prosperity levels. Even in the non-oil economy, Scottish productivity is virtually identical to the UK average. Therefore a currency zone for Scotland and the rest of the UK would be a very, very different creature from the Eurozone, which covers territories from the Ruhr in Germany to Kalamata in the Pelopponese.

A sterling zone would make sense for Scotland and for the rest of the UK. Indeed, recent opinion polls have shown majority support for that in both Scotland and England.

So let's assume that no sensible person would argue against a currency zone. What independence would give Scotland is the ability to set our own fiscal and economic policy, within the context of a stable monetary policy. It would give us the flexibility to provide specifically Scottish policies for specific challenges. And above all, it would allow us to promote sustainable economic growth.

Tonight, I will give the UK Government 6 of the best – by outlining just six examples of the fiscal opportunities that independence would provide.

The first of these is capital investment. I have already made clear our determination to safeguard such investment. Most countries can use borrowing powers for this purpose. However at the moment, the Scottish Government has no borrowing powers whatsoever – we are actually given less responsibility than a local authority or Transport for London in that respect.

Scottish Water is a good example of the difficulties this causes. Scottish Water - which is in public ownership – has been a substantial success story in Scotland. It has managed its infrastructure well, reduced water rates for both businesses and consumers and last winter was even able to send 160,000 litres of water to Northern Ireland during the water scarcity in the province. It is, on any measure, a social, economic and environmental success.

Scottish Water has a massive capital investment programme. With borrowing powers, it could have the flexibility to accelerate its investment for the next two years – pumping demand into the economy and enhancing its asset base. But it is currently prevented from doing so by Treasury rules, which effectively penalise the Scottish Government if Scottish Water decides to borrow money. This is unfair and inefficient.

What makes it particularly absurd is that Scottish Water could borrow money cheaply and easily. It has a large asset base to borrow against, and it also has a totally reliable cash flow in the form of water charges. If Scottish Water were allowed to borrow money, it would soon develop a bond rating comparable to, let's say Network Rail, and perhaps even better than the UK Treasury itself!

Secondly, control of our own taxes is not just about the general rate of taxation. It is also about nuances within the system, and supporting specific economic sectors. The creative industries are a good example of this – one of the industries of the future, and a sector in which Scotland deservedly enjoys a worldwide reputation.

Jonathan Mills, the director of the Edinburgh International Festival, in stressing the importance of the creative industries, has said that tax incentives would be valuable "to allow Scotland's cultural sector to continue to flourish and expand."

Within this, video games is a specific example of an industry where Scotland can punch well above its weight – with clusters of companies in Dundee, Edinburgh and Glasgow; internationally recognised university courses; and world-famous successes such as Grand Theft Auto.

However this success story is at risk, in a highly mobile industry, partly as a result of tax incentives offered in Canada, the US, Australia and other countries. That is why TIGA, the chief computer games industry body in the UK, has stated that the UK Government is “failing to invest in the Scottish and UK games sector” and that Scottish independence could “absolutely reshape games industry policy across Scotland”.

If Scotland had control of these levers of growth, we could provide the right tax environment to boost sectors like this – which are of major importance to Scotland, but can fall below the UK government’s radar.

Thirdly, independence would also allow us to support the overall business environment, rather than specific sectors. My view is that an independent Scotland would compete for inward investment primarily by advertising the quality of our workforce, our natural resources and our quality of life and communications links. We have no wish to enter a “race to the bottom” with anyone.

However metropolises like London, or large countries, can exert a centrifugal force which draws power towards them. Small countries, and regional economies, need a fiscal edge to encourage decision-making centres to settle. Those headquarters and decision-making centres in turn create prosperity.

For this reason, the Scottish Government has modelled the impact of a 3% reduction in corporation tax. Our modelling concluded that such a reduction could support 27,000 jobs, while supporting the rebalancing of the economy by boosting exports.

The fourth initiative which we could use to boost growth is to vary specific taxes which have a broad impact across the economy. When the Scottish Government increased the renewables obligation for wave and tidal power, for example, the cost of that was negligible, since the sector was and is tiny in production terms. The subsequent benefits, however, have been enormous in encouraging companies to invest and research in Scotland. A majority of the world’s wave and tidal devices are being tested in Scotland at the moment.

Air Passenger Duty is another example of a tax that could soon deliver significant benefits for Scotland.

At the moment one part of the UK, London, has airports which are already at capacity, while other parts of the country need to encourage direct links. It makes no sense to have a common rate for this duty.

Michael O' Leary, Chief Executive of Ryanair, has today said that

"In my view Scotland and its tourism industry would benefit dramatically from having control over Air Passenger Duty. This would significantly increase flights, frequencies, connectivity and jobs for Scotland."

The realisation of the potential attractiveness of a devolved air passenger duty led the UK Treasury to veto it being in the Scotland Bill. This accords with what I have come to believe is the Treasury maxim: "devolve as little as possible; when you do, make sure that it's something they can't use; if all else fails, attach enough rules to it to stop whatever you are forced to devolve from working."

The Treasury's approach to air passenger duty demonstrates this maxim holds true.

My FIFTH additional opportunity we could seize under independence is to make the best possible use of our energy resources.

Those resources are unparalleled in Europe. We have 25 % of Europe's tidal power potential, 25% of its offshore wind potential, and 10% of its wave power potential.

Which isn't bad for a nation with less than 1% of Europe's population.

We also have approximately 40 years of oil and gas reserves and so still have an opportunity to establish an oil and gas fund.

Some people argue that there is no point in setting up such a fund in times of budget deficit. I disagree. As I mentioned earlier, between 2005 and 2010, Scotland had a relative fiscal position £7.2 billion better than that of the rest of the UK. There would be different ways of using this comparatively strong position – we could increase spending, reduce taxation, reduce borrowing or establish an oil fund for investment. At the very least, Scotland would have the option of investing in an oil fund in years when it ran a current budget surplus.

If Scotland had been independent in 1979, oil revenues could have reduced our public sector debt from 39% of GDP in 1979 to 0% by 1983-84, and we would then have continued to run budget surpluses throughout the late 1980s.

Scotland's per capita share of UK public sector net debt in 2009-10 was approximately £65 billion. If we had had been able to establish a sovereign wealth fund as North Sea oil revenues started to come on stream, then it is likely that Scotland would currently have financial ASSETS worth anything from £87 billion to £117 billion.

But let's look forward. Even just £1bn a year, invested over 20 years, would create a fund for Scotland worth just under £30 billion.

Norway, Alberta and Alaska all have funds of this nature, as do many countries in the Middle East, North Africa and central Asia. This lecture theatre, indeed, is named after Sheikh Zayed, the man who established the largest oil fund in the world - for Abu Dhabi.

In 1990, Norway established its Oil Fund with the first investment made in 1996 following a modest contribution of just £200 million. Its returns have averaged 4.2% a year since 1998, and it is now the largest pension fund in Europe with a value of approximately 1 per cent of global equity markets. It is currently worth 3 trillion kroner or £330 bn – over £65,000 for every person in Norway.

Harold MacMillan, towards the end of his career in public life, is said to have likened the Thatcher Government's use of privatisation proceeds – and this is a characteristically grand analogy that he was making - to selling off the family silver to pay for the grocery bills.

The conduct of successive UK Governments is in many ways far worse than that. It is as though they have won the lottery jackpot and then not bothered to set up a savings account!

This weekend I will meet with Nobel Laureate and former Chief Economist of the Word Bank, Joseph Stiglitz, who I'm delighted to say is now a member of the Scottish Government's Council of Economic Advisers.

It is appropriate I will meet Professor Stiglitz in Aberdeen – the energy capital of Europe – to discuss among many other things, the benefits to Scotland of establishing an oil fund.

Speaking on a BBC Newsnight Scotland programme a little over a year ago he said:

"You [the UK] squandered that wealth, you took all that North Sea oil and you did very well for that period because you were living off your wealth.

“You mistook the success of the Thatcher era as a success based on good economic policy when it was really a success based on living off your wealth and leaving future generations impoverished.”

He then warned it was now “imperative” that an oil fund be set up in order to ensure that future generations can benefit from the wealth that still exists off Scotland’s shores.

The development of an oil fund for Scotland, once fiscal conditions allow, would promote economic responsibility and stability. Revenues could be invested, rather than spent on current expenditure, during good financial times, and could counteract the effects of economic downturns.

So those are five of the economic powers. But for the sixth, we need to ask, what is all this fiscal manoeuvring designed to do?

It is intended to increase growth, to broaden the base of our economy and to reindustrialise Scotland.

On a day when the latest unemployment figures came out, we need to look to the future. Edinburgh and Glasgow this week have been named by fDI magazine as Europe’s two top large “cities of the future.” The 2011 Ernst and Young UK Attractiveness Survey report concluded that Scotland was the leading centre for Foreign Direct Investment in the UK in terms of employment generation.

Why is this? The reason is that a host of companies see the Scotland’s potential for growth. I see Scotland’s potential for reindustrialisation.

Europe will need energy from the seas in the 21st century, as it meets the challenge of becoming a low carbon economy. This is an area where Scotland has a huge competitive advantage. We will be able to produce energy better and cheaper than anywhere else – and in deeper waters.

Reform Scotland has indicated that, even using conservative assumptions, by 2020 Scottish electricity exports could increase by £2bn per year by 2020.

Scotland’s world class universities research base will also come to the fore in this process. The Scottish Government has established the Saltire Prize – one of the largest challenge prizes in the world – in conjunction with the National Geographic, to encourage the development of commercially viable marine energy. And we are supporting options to pioneer carbon capture and storage technology at Peterhead.

Scottish invention was crucial to the development of the industrial revolution. The advances made in clean energy in the next decades will be equally transformational for the world economy. I am determined that many of them, too, will be developed in Scotland.

Finally, clean energy will facilitate a transformation of the Scottish economy – it provides an opportunity for the reindustrialisation of Scotland. Scotland has a reputation for manufacturing and engineering excellence which goes back decades – to when the phrase "Clyde built" was known around the world for quality.

That manufacturing base is now significantly reduced, of course – partly through inevitable economic change, and largely through misguided policy. But Scotland does still have a strong core of skill in this field. Recently I was in Dundee to launch Michelin's European factory of the future. One of the workers said to me that engineering was part of Scotland's DNA.

Indeed it is.

And thanks to North Sea oil, we have particular experience of engineering and maintenance work in extreme weather conditions.

That inheritance will be used as we start to manufacture the turbines which will power Scotland and the wider world in the future.

Major overseas companies such as Mitsubishi, Gamesa, Samsung, ABB, Alstom, E.ON and Vattenfall are already working with leading Scottish energy and engineering firms such as Scottish and Southern, Scottish Power, Clyde Blowers, the Wood Group and Global Energy to invest in the development of pioneering wind and marine energy technologies.

Indeed only a few days ago we saw the announcement that the new Offshore Renewable Energy 'Catapult' innovation centre for offshore renewable will be based in Glasgow. This announcement builds on the £90 million engineering centre for Strathclyde University announced by the Scottish Government and Scottish Enterprise last year.

Up to 1000 academic and industry engineers working in Glasgow – the city which dominated the marine engineering of the industrial revolution – planning the engineering leap forward which will dictate the marine energy revolution of this century.

Scotland is already becoming recognised internationally as a powerhouse in green energy. Scotland's great cities and ports are ideally-placed to become a key hub for the rapidly growing multi-billion pound offshore renewables industry. We would be able to do much more with greater powers.

Currently we don't even have control of the Crown Estate Commissioners who manage Scotland's seabed out to 12 nautical miles, and almost half of its foreshore. The licenses – and revenues - of much of our offshore energy are therefore in the hands of unelected commissioners accountable to the UK Treasury. Devolving control of Scotland's seabed to Scotland is a key ingredient in delivering the full benefits of the marine renewable energy revolution for Scotland, and ensuring that the benefits are shared widely across our communities.

Ironically, however, as we try to reindustrialise Scotland, the party which was responsible for much of the deindustrialisation of Scotland has started to decry those ambitions.

Their attacks on renewables are an attack on existing and expected jobs which are much needed given the economic record of successive Westminster governments. Their growing campaign against renewables is an attempt at economic vandalism not seen since Mrs Thatcher's days.

An attempt which is especially pernicious since Scotland's emerging success in renewable energy illustrates the economic benefit of the sector to our nation, communities and families. That should be encouraged not attacked.

At the heart of the case for independence is a simple principle. The people best placed to act in Scotland's best interests are those who choose to live and work in Scotland. At the moment, however, many of the key decisions affecting Scotland are taken at Westminster – by a Government which has fewer than a quarter of Scotland's MPs, and whose dominant party has only one Member of Parliament in Scotland.

The consequences are seen in an austerity measures that few people in Scotland voted for; the forthcoming welfare reform legislation; and potentially, the decrying of Scotland's best growth opportunity of the next generation.

An independent Scotland would pursue policies of ambition and responsibility. We would use Scotland's natural resources and skilled workforce to build a sustainable economy – based on producing goods and services that people actually want, rather than living off the illusory profits of periodic asset booms.

The rest of the UK has much to gain from the emergence of a secure, prosperous ally to its north. An independent Scotland would seek only to make a responsible contribution on the European and world stage – and that would benefit all of the nations of these islands.

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