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BRIEFING

Independent Scotland: The Road to Riches

By Gabriel Stein

Over the period 1992 to 2004, gross value added for the United Kingdom grew by an annual average of 5.4%. Over the same period, gross value added in Scotland grew by 4.7%. The difference between gross value added and the more common gross domestic product (GDP) measure is that GDP includes taxes on products less subsidies on products (the so-called Basic Price Adjustment). Hence gross value added can in some ways be seen as a more accurate estimate of a country's productive potential. Scotland's gross value added growth is therefore approximately 87% of that of the entire UK.

Lombard Street Research estimates the UK's trend GDP growth rate at 2.4%. If we assume that the relationship between trend GDP growth in the UK and Scotland alone is the same as that between gross value added growth, Scotland's trend growth rate for GDP would be 2.1%. The difference seems trivial. However, the power of compound interest is such that this means that the UK economy doubles in size every 30 years, while Scotland's economy doubles in size every 34 years. As time goes by, the disparity between Scotland and the rest of the UK therefore widens.

Let us now assume that Scotland becomes independent. The new Scots government attempts to emulate the Republic of Ireland by reducing taxes, cutting spending and creating a business-friendly environment. As a result, over a five-year period (say) Scotland's trend growth rate rises from 2.1% to Ireland's 7% (OECD estimate for the average over the period 1995 to 2004). Scotland then continues to grow at that pace for another five years before the law of diminishing returns sets in and the trend growth rate begins to decline (as Ireland's already is; the latest OECD estimate is for 5.1% in 2007).

Where would this leave Scotland ten years down the line? The absence of official GDP levels for Scotland makes this a somewhat difficult calculation. However, in relative terms, it is possible to make predictions. Setting an index level of 100 for GDP in Year 1 of Scottish independence, by the end of year 10, the index will be 171.5. In other words, GDP – and this is all real GDP – would, under the assumptions made above, have grown by slightly more than two thirds.

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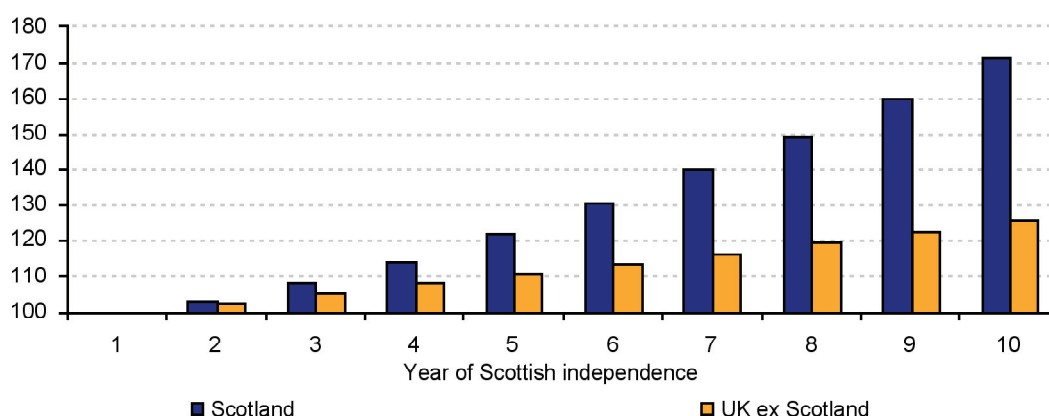
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By contrast, GDP in the rest of the UK would have grown by rather less. The evolution of gross value added in the UK excluding Scotland over the period 1992-2004 is actually almost identical to the number including Scotland. While we can assume some possible benefit to the UK growth rate of Scotland leaving, it is unlikely that the rump UK would be prepared to implement a radical fiscal reform similar to the one we are postulating for Scotland. So if we assume that the rump UK trend growth rate would be 2.6% instead of 2.4%, by year 10 of Scottish independence, rump UK GDP would have gone from an index of 100 to one of 126, ie growth of a little more than a quarter.

GDP growth following Scottish independence, index year 1=100



It is difficult to put this in monetary terms. However, in 2004, household income per head in Scotland was £18,001. In England (and this is an unfair comparison, since income in Wales and Northern Ireland were lower than in England and would therefore have pulled down the figure for rump UK), it was £19,736. Using the assumptions detailed above, ten years later would have the numbers at £30,782 in Scotland and £24,867 in rump UK. Of course, this ignores that the number is already likely to have risen between 2004 and 2007 and would presumably rise further before Scottish independence became a reality. **But the shift from £1,700 behind to £6,000 ahead is an ample illustration of the potential inherent in a fast-growing independent Scotland.** As for rump UK, the current situation where Scotland is subsidised by England (or at least perceived to be such) means that it too would be better off.

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