



## Impact on the UK of Scottish independence: social security and tax credits

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Following the creation of the Scottish Parliament, welfare (i.e. social security and tax credits) remained one of the few areas of domestic policy wholly reserved to the United Kingdom Parliament.

In the event Scotland becoming an independent country, the Scottish and Westminster governments would have to address two main issues:

- How to deliver benefits, pensions and tax credits during the initial transitional period following independence, given existing unified systems and structures; and
- In the longer term, how the welfare systems of Scotland and the rest of the UK should deal with cross border matters, such as individuals moving from one territory to the other, and whether one country's benefits should be exportable to the other.

Key points which emerge from consideration of these matters include:

- Sharing administration of benefits between Scotland and the rest of the UK for a transitional period following independence would minimise risks but limit divergence of policies.
- Agreement would have to be reached on how the two countries' welfare systems should relate to each other in the longer term.
- The EU social security co-ordination rules would provide a detailed framework for how the two systems should interact, and Scotland remaining part of the "Common Travel Area" would make it easier for people moving between the two countries.

This note looks in more detail at these issues. It does not consider the welfare policies a Scottish Government might pursue, and related issues such as affordability.

A separate Library briefing – [SN06914](#) – looks at the implications for pensions in the continuing UK of Scotland becoming independent.

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## 1 Introduction

Following the creation of the Scottish Parliament and the National Assembly for Wales, welfare provision<sup>1</sup> remained one of the few areas of domestic policy wholly reserved to the United Kingdom Parliament.<sup>2</sup>

Maintaining a single UK-wide welfare system has been justified on a number of grounds. Uniformity of entitlements and obligations is said to be in line with the principle of ensuring broadly common “social citizenship.” A unified system enables the pooling of risks and resources, guaranteeing the same levels of social protection regardless of local economic or demographic conditions. There are also said to be strong practical and administrative reasons for maintaining a single welfare system: aligning rules, processes and procedures allows entitlements to be more readily transferable throughout the UK. In addition, economies of scale mean that services can be delivered more efficiently and effectively at the national level.<sup>3</sup>

Whatever spending decision an independent Scotland chose to make, welfare would inevitably remain the biggest single area of expenditure. In 2012-13 spending on social security benefits, tax credits and state pensions in Scotland totaled £17.7 billion - around 27% of all government spending in Scotland, and equivalent to just over 12% of Scottish GDP (assuming a geographical share of North Sea oil) or £3,336 per person. In the UK as a whole, social security expenditure equated to just over 13% of GDP, or £3,274 per person.<sup>4</sup>

Given the importance of welfare, it is surprising that until recently little attention has been given to how an independent Scotland’s welfare system would relate to that in the rest of the UK, and vice versa. In the event of a yes vote, the Scottish and Westminster governments would have to address two main issues:

- How to deliver benefits, pensions and tax credits during the initial transitional period following independence, given existing unified systems and structures, and the fact that benefit claims may not be administered in the same territory in which they are made; and

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<sup>1</sup> Here we use “welfare provision” as shorthand for social security benefits (and associated policies including welfare to work schemes), state pensions and tax credits.

<sup>2</sup> Although social security is devolved in Northern Ireland, the long standing “parity principle” - now reflected in the Northern Ireland Act 1998 - is intended to ensure that, as far as possible, a single system of social security, pensions and child support operates throughout the UK. Funding arrangements also create a strong incentive to maintain parity. The UK Government has recently announced penalties in the form of reductions to Northern Ireland Executive budgets “to reflect savings foregone as a result of the lack of progress on welfare reforms already in place in the rest of the United Kingdom.” These are expected to total £87 million in 2014-15, rising to £114 million in 2015-16: HC Deb 8 April 2014 c228w

<sup>3</sup> See the final report of the Calman Commission on Scottish Devolution, *Serving Scotland Better: Scotland and the United Kingdom in the 21<sup>st</sup> Century*, June 2009, Part 5-L; HM Government, *Scotland analysis: Work and pensions*, Cm 8849, April 2014, Annex A, para A.14

<sup>4</sup> Scottish Government, *Government Expenditure and Revenue Scotland (2014)*, March 2014

- In the longer term, how the welfare systems of Scotland and the rest of the UK should deal with cross border matters, such as individuals moving from one territory to the other, and whether one country's benefits should be exportable to the other.

## 2 Welfare during the transitional period

The [Expert Working Group on Welfare](#) appointed by the Scottish Government looked at the existing infrastructure for delivering benefits and tax credits in the UK, and at its geographical split. It found that, with the exception of certain disability and carers' benefits and services provided by the National Pensions Centre in Newcastle, benefit claims from people living in Scotland were administered from locations within Scotland. It also found that for working age and pensioner benefits, Scottish locations played a significant role in administering claims from the rest of the UK, covering millions of claimants.<sup>5</sup>

The Expert Working Group concluded that while integrating services immediately within the Scottish Government *could* be achieved, the scale and complexity of the task would be considerable and there could be a significant risk to the continuity of service to benefit claimants both in Scotland and in the rest of the UK. It concluded that sharing services between the governments following independence would be the best way of safeguarding delivery of benefits during the transitional period, as well as being the most efficient and cost effective arrangement for both Governments. The Group recognised however that continuing to share services for a period would mean that a Scottish Government might not be able to implement some of its "early priorities" for change to the benefits system.<sup>6</sup>

In response to the Expert Working Group, the Scottish Government agreed that there should be a transitional period of shared administration for delivery of benefit payments. It would therefore seek agreement with the Westminster Government in the transitional period covering matters including the term of the agreement, the services each government would provide, financial arrangements for providing those services, data sharing and record keeping; and contracts, leases and third party arrangements.<sup>7</sup>

However, the Scottish Government proposes that shared administration should last only until 2018 and should not delay implementation of its "priorities for change" from 2016. These include abolition of the underoccupation deduction from Housing Benefit, halting the rollout of Universal Credit and Personal Independence Payment to secure key changes to meet Scotland's needs, and the linking of benefit and tax credit increases to inflation.<sup>8</sup> Further information on its proposals can be found in a press release issued by the Scottish Government on 4 June 2014, [Government responds to Welfare Report: Independence needed to reform welfare and tackle poverty](#).

On 24 April the Department for Work and Pensions published a [Scotland analysis](#) looking at the implications of Scottish independence for social security, pensions and welfare to work policies.<sup>9</sup> The UK Government contends that during any transitional period involving sharing

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<sup>5</sup> [Expert Working Group on Welfare Report](#), May 2013, Chapter 4

<sup>6</sup> Ibid. para 4.71

<sup>7</sup> Scottish Government, [Scotland's referendum on 18 September 2014 is a choice between two futures](#), 26 November 2013, Chapter 4

<sup>8</sup> Ibid.

<sup>9</sup> Department for Work and Pensions and Scotland Office, [Scotland analysis: Work and pensions](#), Cm 88849, 24 April 2014

of systems and services an independent Scottish state **would not** be able to make changes to existing policies or processes **or** opt out of ongoing welfare reforms. To do so, it argues, would require “the prioritisation of changes desired by an independent Scottish state over the needs of the UK Government.” Reconfiguring the current system to meet the demands of two governments with different policies would, it believes, introduce additional costs and risks and “would not be in the interests of the government of the continuing UK.” Moreover, it says that if an independent Scotland did not use sterling as its currency, any sharing of benefit systems would not be possible **even for a transitional period**.<sup>10</sup>

The analysis continues:

Therefore an independent Scottish state would have to introduce its own IT systems and delivery services. Legislating, designing, building, testing and introducing its own systems and delivery infrastructure in 18 months (according to its own timetable for priority changes) would be a huge challenge for an independent Scottish state requiring expertise, the negotiation and awarding of contracts, significant upfront investment and a lengthy lead in time. The likelihood of accomplishing all this activity within a compressed timetable presents inherent risks and, potentially, escalating costs.<sup>11</sup>

The UK Government’s analysis concludes that disentangling current services and contracts would be difficult and expensive, not only for Scotland but also for the rest of the UK. While noting that it would be “highly unlikely” that the UK would agree to share delivery services with an independent Scotland, since it is “hard to see how this would be beneficial to the continuing UK”, it adds that any such agreement would have to be subject to negotiation. In any such negotiations, the UK Government has made it clear that it would focus on the needs of the citizens in the remaining UK and that its priority would be the maintenance of an “effective, efficient and robust” system for delivering UK Government policies, and continuing to deliver its programme of welfare reform.<sup>12</sup>

On 7 July 2014 the House of Commons Scottish Affairs Committee published a report, [The Referendum on Separation for Scotland: Implications for Pensions and Benefits](#).<sup>13</sup> The Committee concluded that the Scottish Government’s plans to establish an independent welfare system that better reflected Scotland’s priorities by 2018 was “over-optimistic”, and that in reality the process would take much longer. It added (original emphasis):

**66. There is clear evidence that the process of establishing a new welfare system would be difficult and costly. Our evidence indicates that the process would take many years, and we do not believe that interim changes of the sort the Scottish Government has promised could be made in the timescale it has set; nor is it clear that UK systems could in reality be used to administer two separate benefits regimes. The Scottish Government should produce further analysis of the methodology and costings by which a transitional welfare system could be implemented. The Scottish Government should not make promises it cannot deliver.**

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<sup>10</sup> Ibid. p75

<sup>11</sup> Ibid. p75

<sup>12</sup> Ibid. p79

<sup>13</sup> HC 498 2014-15

### 3 Relations in the longer term

Detailed consideration would have to be given to how the welfare systems of an independent Scotland and the rest of the UK should interact with each other, beyond the transitional period. This could become more problematic over time, if policy decisions result in significant differences emerging between the two countries' systems.

Questions that would need to be resolved include which state should be responsible for paying benefits to a person living in one country but working in the other, or when a person moves permanently from one country to the other. Other issues to be addressed include whether, and how, periods of employment, residence and contributions paid in one country should count towards entitlement to benefits and pensions in the other; and, where a person has paid National Insurance contributions in both countries, whether and how responsibility for paying contributory pensions/benefits should be shared between the countries.

The United Kingdom already has a number of reciprocal [social security agreements](#) with other countries which cover situations such as these. However, the agreements vary widely in scope, both in terms of the benefits covered and the persons to whom they apply. Were an independent Scotland and the rest of the UK to enter into negotiations on a bilateral social security agreement, a key consideration for both governments would be the need to avoid cross-border movements becoming an undue burden on one country. Differences in entitlements as a result of policy decisions following independence could potentially create incentives for people to move from one country to the other.

If an independent Scotland were to become part of the European Union, the long-standing provisions in EU law on the co-ordination of social security for people moving between Member States would provide a "ready-made" solution to the problem of how the Scottish welfare system should interact with that in the rest of the UK, and with the systems in each country in the European Economic Area (EEA).<sup>14</sup>

The main purpose of the co-ordination rules is to ensure that people who choose to exercise the right of freedom of movement do not find themselves at a disadvantage in respect of social security benefits – e.g. if they should fall ill or become unemployed while working in another EEA state. The Regulations do not guarantee a *general* right to benefit throughout the EEA; nor do they harmonise the social security systems of the member states. Their primary function is to support the free movement throughout the EEA by removing some of the disadvantages migrants might encounter. They achieve this by, for example:

- prohibiting discrimination in matters of social security systems on grounds of nationality;
- clarifying which state is responsible for paying benefits in a particular case (the "single state principle");
- allowing a person's periods of employment, residence and contributions paid in one EEA country to count towards entitlement to benefit in another country (the principle of "aggregation"); and

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<sup>14</sup> The provisions were in EC Regulations 1408/71 and 574/72, but from 1 May 2010 these were replaced by "modernised" Regulations 883/2004 and 987/2009. The EEA includes the 28 countries of the European Union, plus Iceland, Liechtenstein and Norway

- allowing people to take certain benefits abroad with them to another EEA state (the principle of “exportation”).<sup>15</sup>

Were the EU social security co-ordination rules to apply following independence, there would be greater clarity on entitlement to benefits for people moving from one territory to the other, or where a person had spent periods living and/or contributing in both countries (or indeed in any EEA country). The co-ordination rules would also resolve many of the cross-border issues regarding State pensions.

Not all benefits are covered by the co-ordination rules, including those classed as “[social assistance](#).” Eligibility for social security benefits more broadly for those moving between the territories could depend on whether Scotland remains part of the [Common Travel Area \(CTA\)](#). This comprises the UK, the Republic of Ireland, the Channel Islands and the Isle of Man. By virtue of their country being part of the CTA, Irish citizens enjoy certain advantages over nationals of other EEA countries with regard to access to certain UK benefits (as they satisfy the [habitual residence test](#) and have a “[right to reside](#)”). Were an independent Scotland not to become part of the CTA, individuals moving from Scotland to the rest of the UK, and vice versa, could find it more difficult to access benefits than people moving between Ireland and the rest of the UK.

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<sup>15</sup> See European Commission, [EU Social Security Coordination](#), accessed 15 April 2014