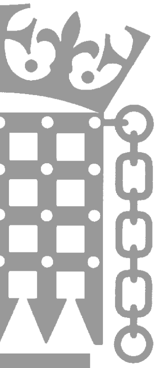

HOUSE OF LORDS

Select Committee on Economic Affairs

2nd Report of Session 2012–13

The Economic Implications for the United Kingdom of Scottish Independence

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Q refers to a question in oral evidence.
Witness names without a question reference refer to written evidence.

The Economic Implications for the United Kingdom of Scottish Independence

CHAPTER 1: INTRODUCTION

Why this report?

1. In 2014, the people of Scotland will take a momentous decision. They will cast their vote in a referendum on their country's future. If they vote "Yes" to independence, the 300-year old Act of Union with the rest of the UK would lapse. After a period of negotiation, Scotland would emerge as an independent state. If they vote "no" a divisive issue in Scotland will be settled and it will continue its existence as part of the United Kingdom, with its own devolved government.

2. The Scottish Government's view of the way forward after a "Yes" vote in 2014 is set out in *"Scotland's Future: from the Referendum to Independence and a Written Constitution*", published on 5 February 2013. It envisages that Scotland would become independent in March 2016. The deputy First Minister of Scotland calls it a first contribution to clarify the process that would follow a "Yes" vote and proposes to the UK Government "that we now engage in discussions on the process of the transition to independence in advance of the vote".[1]

3. The British Government's approach is very different. It aims to clarify the issues before the referendum and, in the words of the Chief Secretary to the Treasury, "is undertaking a large programme of analysis to establish a robust body of evidence to inform the debate on Scotland's place in the United Kingdom".[2] But, as the Secretary of State for Scotland told us: "What we will not do is get into pre-negotiations."[3]

4. The decision the Scots will have to make is not a simple one. It will have far-reaching constitutional, political and social, as well as economic, consequences. Nor will their verdict be confined in its effects to North of the Border. It will have important implications too for the rest of the UK which again will not be solely economic.

5. It is however on the economic effects that this report will focus. Polling evidence shows that the expected economic impact will be an important factor for the Scots in making their decision. **Voters in Scotland deserve the best evidence-based assessment of the likely economic consequences of independence. We have sought to collect and assess that evidence as part of our analysis of the economic implications for the whole United Kingdom.**

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[1] Foreword, *Scotland's Future: from the Referendum to Independence and a Written Constitution*, Scottish Government 5 February 2013

[2] Q 500

[3] Q 901

6. **This report does not make a case either for or against independence.** We have examined the leading academic, business and political experts on the economics of independence, and we have sought to present their analysis and conclusions in as clear and digestible a form as we can. **We hope to inform the debate both in Scotland and in the rest of the UK in the run-up to the referendum.**

7. This is a simple objective but a complex task. As the evidence we heard made clear, the Scottish and the rest of the UK economies are at present closely integrated. Cross-border trade is far greater than would be the case had they not been for so long a single country: more than two thirds of Scotland's exports of goods and services go to the rest of the UK, mainly to England.[4]

8. This report considers a number of economic aspects of separation, including:

    (i) What might be the impact of Scottish independence on the single market in the United Kingdom? (Chapter 2)

    (ii) What effects would independence have on international investment in Scotland? (Chapter 2)

    (iii) What implications would independence have for the decisions of major as well as of medium and small companies as to where they decide to locate and to what extent would these be affected by the possibility of different regulatory regimes North and South of the border? (Chapter 2)

    (iv) What currency would an independent Scotland use, and what would be the arrangements for its management? (Chapter 3)

    (v) What would be the role of the Bank of England if Scottish financial institutions needed emergency support? (Chapter 3)

    (vi) What arrangements would be made for the regulation in Scotland of Scottish financial institutions? If the Bank of England were expected to support at-risk financial institutions in Scotland, should it also have authority over financial regulation there? Would this be compatible with EU requirements on national regulation by member states? (Chapter 3)

    (vii) What would be the division of assets and liabilities between an independent Scotland and the rest of the UK? How would an independent Scottish Government assume its substantial share of UK national debt? What impact might there be on the creditworthiness of the rest of the UK? (Chapter 4)

    (viii) What would be the underlying fiscal position of Scotland post-independence without a block grant transfer from Westminster? What fiscal policy would an independent Scotland pursue and would it be constrained by fiscal agreements with the rest of the UK? (Chapter 4)

    (ix) Would an independent Scotland become a member of the European Union and on what terms? What might be the impact of the United Kingdom's renegotiation of its relationship to the EU? (Chapter 5)

[4] Q 228

(x) What defence arrangements would exist in an independent Scotland and what implications would these have for the cost of defence in the rest of the UK, including the potential cost of re-siting Britain's independent nuclear deterrent? (Chapter 6)

9. **The economic implications of Scottish independence for Scotland and for the rest of the United Kingdom are not symmetrical. Broadly Scotland's GDP is around one-tenth of that of the rest of the UK.** (See Appendix 5). **The impact on the rest of the UK might still be important in certain circumstances: for example if significant financial institutions based in Scotland and active in the rest of the UK were to fail, that might hit the rest of the UK as well as Scotland. There would be economic as well as strategic implications for the rest of the UK in defence. The main economic effects of independence would be felt in Scotland. An early, transitional problem would be assuming its share, perhaps £93bn, of the UK's public sector debt. The impact on defence strategy of Scottish independence could have significant economic implications for the rest of the UK; so also could the adoption of sterling as the currency of an independent Scotland in monetary union with the rest of the UK, as proposed by the Scottish Government.**

10. One factor in particular adds to the complexity of our task. A "Yes" vote in 2014 would be a vote for independence. It would be followed by a long period of negotiation between the Government of Scotland and that of the rest of the UK on a whole host of issues included in the list of questions above. That process might last for years, said Professor John Kay of Oxford University[5] and other witnesses. Moreover, the President of the European Commission, Mr Jose Manuel Barroso, also made clear to us that a newly-independent Scotland would not automatically remain a member of the European Union.[6] Some EU foreign ministers, including the Spanish, have since expressed agreement.[7] If Scotland wanted membership, it would have to apply and negotiate terms. A newly independent Scotland would not inherit some of the special terms with Europe that currently apply to the United Kingdom, for example its opt-out from the Euro.

11. Given the complexity of these issues, and the relative shortness of time before the referendum, it is of the utmost important that Scottish voters are presented with the key issues as soon and as clearly as possible. Since the consequences of the Scottish vote will also be felt throughout the country, the people of the whole of the UK also need the British Government to state its position. In the course of our inquiry, however, we have become increasingly concerned that both Edinburgh and Westminster are not being open with the Scottish people or the British people as a whole. Examples of the former include the First Minister's rejection of our invitation to give us evidence and the complete refusal of the Scottish Government to accept that it would have to apply for EU membership, as shown by the evidence of the Cabinet Secretary for Finance, Employment and Sustainable Growth.[8] An example of the latter is the official reticence by the British Government on

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5 Q 85

6 Jose Manuel Barroso letter of 10 December 2012 to Lord Tugendhat

7 The Guardian, *'Join the queue' for EU membership, Spain tells Alex Salmond*, 24 October 2012

8 Q 865

the implications and costs of Scottish independence for defence. Although the British Government has now published the first in a series of papers on the issues, on the UK's legal and constitutional framework,[9] they failed to respond in time for our committee's report to a request for a simple list of planned papers on economic themes and a timetable for their publication

12. Even more concerning, many Scottish companies whom we asked for evidence simply refused (though some to their credit accepted: the Chairman of RBS and the CEOs of Standard Life, Aggreko plc and the Weir Group). This was so even though the committee visited Edinburgh and Glasgow to take evidence. Regrettably, and without attributing blame, we formed the impression that a conspiracy of silence seems to have developed in Scotland which is inhibiting open debate; Councillor Gordon Matheson, Labour Leader of Glasgow City Council, even spoke of "a climate of fear [that] even extends to asking the questions publicly".[10] **Scotland needs and deserves a fully-informed debate, based on fact and free from rancour, well before the referendum vote. To help bring it about the Scottish and British Governments should be more open about how they see the outcome of negotiations after a "Yes" vote; each should indicate the "red lines" of its negotiating stance on such crucial issues as currency, defence, division of assets and debts and negotiations with the EU *before* the referendum so that voters can make an informed choice.**

13. The task we set ourselves of providing an objective account is therefore a challenging one. However, amongst academic economists, there is a wide and broad consensus on the issues and the likely scale of their impact. For example, the importance of the future price of oil to an independent Scotland's future fiscal balance, and the blow which even a modest fall would represent to it, came through from much evidence we heard, including the important paper by Professor Alex Kemp of Aberdeen University.[11]

14. The downside risk, of things going badly for Scotland alone, is clear. Its people enjoy an insurance policy against disaster in the form of the willingness of the United Kingdom to draw on its broader resources to protect them in hard times. This would not be so if Scotland goes it alone. On the other hand, the rest of the UK would lose the economic benefit of most oil reserves in the UK Continental Shelf.

15. There are potential upsides too, even though they are harder to quantify. Few of our witnesses endorsed the view that independence would set loose Scottish entrepreneurial spirits in a way that would improve its economic performance, but they could not rule out such an effect either.

16. It will be for the Scottish people to balance their assessments of the risks, which are undoubtedly great, with their hopes for the benefits; and indeed to weigh in the scale with economics the non-economic factors which should inform their decision. **We aim in this report to set out the economic facts and the arguments to help the people of Scotland make their once-in-a-generation decision.**

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9 *Scotland analysis: Devolution and the implications of Scottish independence*, Cm 8554, February 2013

10 Q 714

11 Professor Alex Kemp

CHAPTER 2: THE ECONOMIC REALITIES OF SCOTTISH INDEPENDENCE

The United Kingdom single market

17. The United Kingdom forms a single market of over 60 million people. There are no borders, customs checks, administrative or accounting procedures on the movement of labour, goods or services. Currency, regulation and most taxation are uniform. In short, economic activity within the United Kingdom carries minimal transaction costs. This promotes price transparency and competition and the efficient use of resources between Scotland, England, Wales and Northern Ireland.

Trade

18. Access to markets was a main driver of the Act of Union of 1707 which established the unitary Kingdom of Great Britain. Excluded from England's trade with the colonies, the Scots had tried in the late 1690s to set up their own entrepot on the Darien isthmus, investing perhaps a quarter of the country's liquid capital. After the disastrous failure of the Darien scheme, the Act of Union brought economic security to Scotland and secured England's defences. It led to economic integration of England and Scotland and to greater prosperity in the later eighteenth century as Glasgow tobacco barons, for example, grew rich on colonial trade. The industrial revolution of the nineteenth century and the service-based economy of more recent times have further consolidated the UK single market.

19. After 300 years of union, Scotland's economy and that of the rest of the UK remain closely integrated and the UK market is more truly single than that of the EU. At present, trade with the rest of the UK is worth over two-thirds of Scotland's output (see Appendix 5). Rt Hon Alistair Darling MP reminded us that 94% of Scottish insurance industry products were sold to the rest of the UK and only 6% in Scotland.[12] Mr John Cridland, Director-General of the CBI, told us:

> "The single market is a key UK asset and the certainty and level playing field of rules on tax, law and regulation adds to economic growth … we feel inevitably that if there were two independent countries in this one island there would be a fragmentation of the single market."[13]

20. The United Kingdom single market has helped the Scottish financial services sector to grow. Financial services make up a similar proportion of the Scottish economy as the UK's. But the Scottish economy is dwarfed by the balance sheets of Scottish banks. The total assets of Royal Bank of Scotland (RBS) and Halifax Bank of Scotland (HBOS) are over 15 times Scottish GDP and were more than 20 times its GDP in 2008. Both figures are much higher than for the UK and countries which buckled under the weight of rescuing their banking sectors such as Iceland and Ireland.[14] The banking sector's size creates particular problems for an independent Scotland which

[12] Q 571

[13] Q 279

[14] Scottish Parliament Information Centre, *Banking inquiry: additional material supplied in response to Members Enquiries*, (Edinburgh: SPICe, February 2009), p. 6

will be examined later in this report. Mr Darling and Rt Hon Danny Alexander MP, Chief Secretary to the Treasury, separately reminded us that UK government support for RBS had amounted to a sum equivalent to 211% of Scotland's GDP.[15] [16]

21. **The UK's single market brings economic benefits to Scotland and the rest of the UK. If it fragmented after Scottish independence, Scotland's smaller economy would be disproportionately affected.**

22. The trade policy of an independent Scotland would crystallise after a "Yes" vote. If, after negotiation, it became a member of the European Union, as the Scottish Government intends, single market regulations would apply which would encourage trade. Even if it did not, it must be assumed that it would continue to adhere to the GATT, and the general consensus in favour of free trade, though an autarkic alternative would of course be available to a Scottish Government. A combination of the use of the pound and membership of the EU would clearly make it more likely that the present close trading relationship endures. Professor David Bell of Stirling University said: "For the rest of the United Kingdom, if Scotland stayed with the pound, there would be little disruption of trade flows."[17]

Inward Investment

23. One key objective of an independent Scotland would be to attract substantial investment from outside Scotland. This is an area where Scotland has been successful under devolution. Professor Gerald Holtham, Chairman of the Independent Commission on Funding and Finance for Wales, thought this was in part because "Scotland has a high degree of international recognition in a way that Wales does not".[18] In his view, Scotland would still be attractive to foreign investors after independence. Professor John Tomaney of Newcastle University agreed. He thought that Scottish Enterprise "gave certain kinds of economic development advantages that were not available in the north of England". He added: "Many of the things … in terms of Scotland's ability to attract a higher proportion of foreign direct investment are already there."[19]

24. Many of the same considerations affecting its trading prospects would also influence an independent Scotland's continuing scope to attract investment. Success is again likely to depend on the decisions the Scottish Government takes on some of the issues raised in this report. Preservation of an effective UK single market would be desirable; Professor Tomaney pointed out that Scottish Enterprise had successfully offered investors in Scotland access to the United Kingdom market. Important also would be an independent Scotland's relationship with the EU (see Chapter 5 below).

25. **A single market is not simply a matter of free trade and investment. Its cohesion can also be weakened by divergences over currencies, regulation and taxation. The severity of the threat to the UK single**

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15 Q 570

16 Q 514

17 Q 22

18 Q 340

19 Q 267

market would depend to a large extent on the decisions of the Governments of an independent Scotland and of the rest of the UK.

Currency

26. The Scottish Government at present intends that sterling should be Scotland's currency—though it used to favour the use of the Euro, as Professor Gavin McCrone recalled.[20] Professor Robert Rowthorn of Cambridge University said: "Sterling is probably the simplest currency because Scotland trades on such a large scale with the UK."[21] Business strongly favours retention of sterling, as Mr Iain McMillan, Director of CBI Scotland, made clear.[22] An independent Scotland's use of sterling would raise many questions about monetary policy and financial regulation in the rest of the UK as well as in Scotland; these are discussed in Chapter 3. Despite the Scottish Government's target of March 2016, independence might not occur for some years after a "Yes" vote in 2014 because lengthy negotiations would follow between the Scottish and the rest of the UK Governments, as witnesses including Professor John Kay told us.[23] During this time, it is perfectly conceivable that the relative attractions to a Scottish Government of the pound and those of the Euro could shift in the latter's favour. Scotland might even decide to have a currency of its own, neither Euro nor pound. Use of a currency other than sterling would raise greater transitional risks. If the pound was not the currency, a barrier to trade would immediately arise, a risk foreseen by Mr Keith Cochrane, CEO of Weir Group.[24] The implications of an independent Scotland's use of a currency other than sterling are examined in Appendix 6.

Regulation & Taxation

27. Even with commitment to free trade and a shared currency, the British single market could be eroded if an independent Scotland's regulatory regime came to differ from that of the rest of the UK. There might be (for example) different regimes for health and safety, or different competition regulation, or different rules for advertising. There already are divergent plans for minimum alcohol prices. The prospect of more or different Scottish regulation is unwelcome to Scottish-based business. Sir Philip Hampton, Chairman of the Royal Bank of Scotland, said: "The overriding preference would be for simplicity, because we already have enormous complexity."[25] Mr David Nish, CEO of Standard Life, said: "What I benefit from today is from having a single regulator in a geographical area."[26] Mr Rupert Soames, CEO of Aggreko, pointed out in relation to pensions that "we have a defined benefits scheme. Which side of the border will that fall on? Who will be the pensions protection agency?"[27]

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[20] Q 143

[21] Q 206

[22] Q 651

[23] Q 85

[24] Q 680

[25] Q 762

[26] Q 613

[27] Q 815

28. Professor Bell noted that the Scottish Government had not made use of its power under devolution to vary the basic rate of income tax up to 3p.[28] But Professor McCrone thought: "Over time personal taxation in [an independent] Scotland would be different from England, just as it is in Ireland."[29] Mr Darling doubted if cutting corporation tax in Scotland would be effective: "Suppose Scotland cut its corporation tax and it worked. How long do you think it would be before the rest of the UK thought, 'Well, it's working; [we] will cut our rate too?' … Then you get the ridiculous situation of beggar your neighbour, and the only people laughing are the multinationals who pay corporation tax … I have always been sceptical about whether cutting corporation tax would make a big difference. There is no way that the other side will not retaliate."[30] Mr Cochrane expressed concern about the possible effects on his business of different rates of corporation tax in Scotland and the rest of the UK.[31] Ms Katie Schmuecker of IPPR North thought that the fear that business would drain north in response to low Scottish corporation tax was overplayed.[32] But Mr John Swinney MSP, the Scottish Government's Cabinet Secretary for Finance, Employment and Sustainable Growth, said that the Scottish Government "still take the view that business taxation is an area where we can provide the opportunity to make Scotland an attractive place for investment".[33]

29. One of the arguments for independence is that an independent state can make decisions on e.g. currency, regulation and taxes which reflect the preferences of its people. These decisions need not mean that trade would be greatly diminished. The nature of a country's regulatory regime is one of the factors that affect its costs of production and therefore its comparative advantage in trade. Nevertheless regulatory differences can affect trade relations. **A post-independence Scottish Government and its counterpart in the rest of the UK should try to preserve, as far as possible, the single UK market, which brings economic benefits to both.**

30. As things stand, the economic structures of Scotland and England are very similar.[34] Scotland's output per head of £20,200[35] and its fiscal deficit of 11% of GDP[36] are close to the UK's (see also Appendix 5). But there are already differences, even under devolution. Public sector spending per head is 11% higher in Scotland than the UK overall.[37] Professor Kay said: "The proportion who are employed in public sector activities is about 2% higher in Scotland than in the UK."[38]

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28 Q 27
29 Q 156
30 Q 577
31 Q 684
32 Q 271
33 Q 898
34 Q 100
35 Q 244. Output per head measured by Gross Value Added (GVA) per head.
36 Q 14
37 Government Expenditure and Revenue Scotland 2011–12, Table 5.6.
38 Q 101

31. The “challenges to the medium-term fiscal sustainability of Scotland as a single unit”[39] foreseen by the Chief Secretary to the Treasury would be heightened by an independent Scottish Government’s dependence on volatile net tax revenues from North Sea oil and gas.

32. An independent Scotland would need quickly to establish the legal and administrative framework to promote its interests in the single British and EU markets and more widely. This would require enhanced skills and capabilities in a range of areas now the responsibility of the UK Government, including revenue raising, payment of pensions and benefits, financial regulation, treaty negotiation, defence policy and overseas representation.

33. **Any reduction in intra-British trade and investment following erosion of the single market would be felt in the rest of the UK as well as in Scotland. Given the disparity in size between the Scottish economy and the rest of the UK economy, the effect on the rest of the UK as a whole would be much smaller than that on Scotland.**

Division of Assets and Liabilities

34. All sorts of bodies and departments would need to be divided between the two countries including spending departments, the armed forces and even the NHS. Assets to be divided include natural resources such as North Sea oil and gas reserves. Liabilities include the UK’s public sector debt and other commitments including pensions.

35. What principles would apply to the division? Professor Rowthorn recalled that in the Anglo-Irish Treaty of 1921 the newly formed Irish Free State “agreed to assume responsibility for a proportionate part of the United Kingdom’s debt, as it stood on the date of signature”.[40] Dr Karen Henderson of Leicester University told us that in the ‘velvet divorce’ of Czechoslovakia into the Czech Republic and Slovakia in 1993 the general principle was that property should belong to the republic in which it was located, and that other assets and debt were divided 2:1 in line with the size of the two republics’ populations.[41] The ICAEW argued for a simple approach.[42]

36. Our witnesses agreed that shared physical onshore assets should be apportioned by location, although military installations (see Chapter 6) might need negotiation. Most also agreed that financial assets and liabilities should be apportioned on a per capita basis. **As a starting point, the division of UK physical assets should be on a geographical basis. Financial assets and liabilities should be divided by share of population.**

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39 Q 503

40 Professor Robert Rowthorn. Article 5 of the Anglo-Irish Treaty states: “The Irish Free State shall assume liability for the service of the Public Debt of the United Kingdom as existing as the date hereof and towards the payment of War Pensions as existing at that date in such proportion as may be fair and equitable, having regard to any just claim on the part of Ireland by way of set-off or counter claim, the amount of such sums being determined in default of agreement by the arbitration of one or more independent persons being citizens of the British Empire.”

41 Q 487

42 ICAEW paragraph 12

North Sea oil & gas

37. One of the traditional arguments for Scottish independence is that an independent Scotland would benefit from the bulk of the North Sea oil tax revenues instead of having to share the benefits with the rest of the UK. Professor Rowthorn estimates they would be about 5–10% of Scottish non-oil GDP.[43] Professor McCrone said that, on the expected geographical division, about 90% of revenues would accrue to an independent Scotland.[44] This assumes that Orkney and Shetland remained part of an independent Scotland; if they did not, Scotland's reserves would be reduced by a third, with concomitant effects on tax revenues.[45]

38. These North Sea oil tax revenues are the economic bridge over which Scotland would pass to independence. Our witnesses expect them broadly to make up for loss of the Barnett formula's effect on the Treasury's block grant to Scotland—which allocates Scotland a share of UK public spending—on independence. But revenue from the North Sea is not assured. Output, and therefore tax revenue, is extremely dependent on the price of oil, which is set in world markets. Quite small reductions in price can make much of North Sea oil uneconomic to develop because of high costs. Therefore the benefit to Scotland of keeping North Sea oil will vary with the price.

39. What is the likely future oil price? Estimates of future commodity prices are notoriously subject to large margins of error. It follows that, whatever is the central prediction as to the price of oil, there exists a substantial downside risk, probably greater if forecasts that the US is to become a net energy exporter are accurate. This matters less to a Scotland that is part of the United Kingdom. If oil revenues fall short, they can be replaced by taxes that fall on a largish country (or by spending cuts), so the effect is diluted. In an independent Scotland however oil revenues might amount to some 5–10% of non-oil GDP[46] and some 19% of tax revenues.[47] If oil revenues turned out lower than expected, and they could be substantially lower, that would hit the economy of an independent Scotland hard.

40. Another issue is how long the oil will last. Forecasters generally expect a long term decline in North Sea oil output. Professor Rowthorn said: "If you look over the 25 or 30-year perspective, Scottish oil revenues will decline almost whatever happens to the price of oil."[48] So the Scottish economy will have to cope with a decline similarly in the benefits to the country and its exchequer that North Sea oil brings.

41. There is also the question of decommissioning costs. These are substantial—Professor Alex Kemp estimates them at some £30 billion over 30 years, of which more than 50% would fall on governments in the form of net tax reductions to the companies.[49] The SNP has argued that, since the tax revenues from past oil revenues accrued to the UK as a whole, decommissioning costs too should fall on the UK as a whole. **North Sea oil**

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43 Q 195

44 Q 118

45 Professor Robert Rowthorn's written evidence discusses the oil and gas reserves of Orkney and Shetland

46 Q 195

47 Government Expenditure and Revenue Scotland 2011–12, March 2013, Table 4.6

48 Q 215

49 Q 560

decommissioning costs will be very substantial. The oil companies will want to offset them against future tax due, which would reduce an independent Scottish Government's revenues. How these matters are resolved will have an important bearing on the value to Scotland's economy of oil.

42. To make best use of North Sea oil at any level of price or output, an independent Scotland would need to take over oil industry regulation from the UK Government. Professor Kemp drew attention to the complexities, which would need to be carefully managed, especially during a transition, including licensing, taxation, capital allowances and decommissioning.[50] Asked to forecast net tax revenues from oil production in the Scottish sector of the North Sea, Professor Kemp told us: "I can make a guesstimate that for the Scottish sector it could range annually between £5 billion and £10 billion per year for the next decade."[51]

43. **It remains the case that the Scottish economy would be likely to gain from North Sea Oil revenues. The scale of that gain is much more uncertain as is how long it will last. So is its value to the underlying health of the rest of the Scottish economy, especially given the very real possibility of volatility in output and revenues. Oil alone will not ensure that an independent Scotland is a prosperous Scotland.**

44. As things stand, payments from the British exchequer fund much of the Scottish Government's spending. As with Wales and Northern Ireland, they are made through a block grant, itself funded by general UK taxation to which Scotland makes its contribution. Application of the Barnett formula is however generally recognised as raising the exchequer's block grant to Scotland. Block grant payments would cease on independence. All an independent Scotland's revenue would have to be levied within Scotland. Witnesses thought that oil revenues would broadly make up the loss of the benefit to Scotland of the Barnett formula's effect on the block grant. Professor Kay said:

> "The best way of defining the status quo has been to say that in return for a relatively generous public expenditure settlement, the issue of what the right division of the oil revenues should be is allowed, if not to go away, at any rate to rest on the back burner … it is rather a good deal for Scotland at least in a sense that oil revenues are by their nature rather unstable, whereas the flow of expenditure to Scotland that has come from it [Barnett] is relatively secure. While there is a lot of discussion in Scotland about whether Scotland would be better off in public expenditure terms or not, it is probably not a big issue either way."[52]

After a "Yes" vote in the referendum, the Scottish Government would need to make timely arrangements to levy its own taxes on independence. Even if an independent Scotland's oil revenues broadly made up for the loss of the Barnett formula's effect on the block grant,[53] they would be a less predictable source of revenue than transfers from the British Treasury.

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50 Q 550/Q 553/Q 560

51 Q 553

52 Q 61

53 Barnett Formula Select Committee, 1st Report (2008–09): *The Barnett Formula* (HL Paper 139)

Other assets

45. Aside from oil, Barnett payments and defence (see Chapter 6) many UK functions and institutions would have to be divided on Scottish independence, ranging from tax collection to air traffic control to fisheries protection. Ms Johann Lamont MSP, leader of the Scottish Labour Party, recalled the UN International Law Commission's view that movable state property as well as state debt should pass to the successor states in an equitable proportion.[54] The Institute of Chartered Accountants in England and Wales (ICAEW) favoured a simple approach but recognised that in practice allocations could be highly complex with different rules applying to different assets and liabilities.[55] **Negotiations on division of assets are likely to be intricate and lengthy, leading to uncertainty until successor systems and institutions prove themselves in Scotland and the rest of the UK.**

Debt/liabilities

46. According to the Office of Budget Responsibility (OBR) the UK's Public Sector Net Debt (PSND) was £1,104bn in the financial year ending in March 2012.[56] Assuming that this debt is shared between an independent Scotland and the rest of the UK on the basis of size of population, Scotland would be allocated 8.4% or £93bn. If North Sea oil is allocated on a geographical basis (see paragraph 37), the ratio of Scottish debt to GDP would be around 62%. This measure does not include what would become Scotland's share of known future UK liabilities, such as payment of public sector pensions in Scotland. **Added together, an independent Scotland's share of the UK's public sector debt and its share of the UK's known future liabilities, based on relative size of population, would be around 123% of GDP.** These figures are set out more fully in paragraphs 86–89 below. A newly-independent Scotland would have no track record with international lenders. Sir Nicholas Macpherson, Permanent Secretary of the UK Treasury, said:

> "Even countries that are pursuing incredibly … tight fiscal policies, such as the Netherlands and Finland, pay a premium on their debt compared to Germany. So even on day one, if Scotland was pursuing a surplus, there would probably be some sort of premium."[57]

An independent Scotland would need to service its own sovereign debt and to manage its spending, borrowing and taxation in such a way as to win and retain the confidence of global lenders that its debt burden is manageable.

47. After agreement was reached on how much public sector debt would be assumed by an independent Scotland, there would be the important issue of how to transfer this debt to an independent Scotland. This is not a straight forward matter. It would take a newly established independent Scotland some time to establish a successful credit history (see Chapter 4). This is an important matter for Scotland and the rest of the UK. **It is for the Scottish**

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54 Johann Lamont MSP paragraph 37

55 ICAEW paragraph 12

56 Office for Budget Responsibility (March 2013), *Economic and Fiscal Outlook*, Table 1.4

57 Q 512

Government to explain to voters well ahead of the referendum how it intends to take over its share of the UK's public sector debt.

Fiscal

48. An independent Scottish Government would have to manage its own budget. Estimates show that in 2011–12 a separate Scotland with geographical share of North Sea oil revenues would have had a budget deficit of 5.0% of GDP, comparing well with a UK deficit of 7.9% of GDP.[58] The prospective budget deficit of an independent Scotland is harder to estimate since it is not clear whether Scotland would raise enough tax revenues to compensate for loss of the block grant. Moreover, the UK has (still) a strong credit rating based on a very long record of international borrowing. International markets might exact higher interest payments from an untried Scotland much more dependent for income on volatile oil revenues. This issue is explored further in Chapter 4.

Entrepreneurship, management and productivity

49. Ultimately the prosperity of an independent Scotland will depend on the productivity of its businesses and workers. That in turn will largely depend not just on how much firms invest, but on the skills of their managers and workers, and entrepreneurship. Such factors are hard to predict let alone quantify, but they will in the end determine if an independent Scotland is a success economically.

50. So far as management skills are concerned, Scottish managers have established some powerful reputations—not least in countries other than their home country. The Scottish financial services industry boom depended on the reputation for probity and canniness, though this has been somewhat eroded by the subsequent bust. Scotland has produced not only great managers but the great professionals—lawyers, accountants, actuaries—that great managers need to succeed.

51. So far as entrepreneurship is concerned, Scotland's position is less strong. There are of course some Scottish firms which have grown to be acknowledged successes. But Scotland needs to do better at incubating new businesses. As Mr Ian McKay of the Scottish Institute of Directors pointed out: "Scotland continues to have a very poor record of business start-ups."[59] Data from the Office of National Statistics show that the share of innovative businesses and the amount of expenditure on research and development relative to output in Scotland is lower than the UK average.[60]

52. Few of our witnesses believed that independence would set loose a new spirit of entrepreneurship north of the border, one enthused by the historic destiny of this small nation to strive and to succeed. Others, particularly the economists who gave evidence to us, are less convinced. Professor Kay was unsure:

> "Perhaps the largest issue in the whole debate, is whether we think that an independent Scotland would to some degree help release

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[58] Government Expenditure and Revenue Scotland 2011–12, Table E.4

[59] Q 648

[60] ONS Regional Economic Indicators 2013

> entrepreneurial energy in Scotland, or whether the policies of a Scottish Government would depress them. I can see arguments on both sides."[61]

Professor McCrone did not believe independence would generate a wave of entrepreneurship.[62]

53. **There can be no definitive answer to the question of whether an independent Scotland would be more prosperous, less prosperous or as prosperous as Scotland is now. Our report identifies clear threats to Scotland's prosperity under independence; while the upside is uncertain.**

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61 Q 100

62 Q 169

CHAPTER 3: CURRENCY OPTIONS AND CONSEQUENCES

54. **The choice of currency is perhaps the most important economic decision an independent Scottish Government would face.** As well as establishing the notes and coins in everyday use, it would have far-reaching consequences for economic policy. If, as the Scottish Government currently proposes, an independent Scotland were to retain sterling, monetary policy would continue to be set by the Bank of England. This has implications for the regulation of Scotland's financial sector which in turn is likely to have implications for tax and spending policies (see Chapter 4). **What may seem like a dry and technical issue is, as Professor Gavin McCrone reminded us, "of the greatest importance for those of us living in Scotland".**[63] It is essential that clarity is achieved on this decision and its consequences before the independence referendum. Alternatives to sterling, such as Scotland adopting the euro, or having its own currency, are discussed in Appendix 6.

Current Government positions

55. An independent Scotland could continue using sterling without the rest of the UK's consent in the same way some Latin American countries have adopted the US dollar and Montenegro uses the Euro. Under this option—known as dollarisation—Scotland would have no formal central bank and no access to the services of, or influence over, the Bank of England. But Scotland has a large financial services sector which relies on access to central bank services. Professor Jim Gallagher of Nuffield College, Oxford said that, because of this, dollarisation "is not a viable option" for somewhere like Scotland.[64]

56. The Scottish Government is not therefore interested in dollarisation and favours a monetary union between an independent Scotland and the rest of the UK. Mr John Swinney MSP, Cabinet Secretary for Finance, Employment and Sustainable Growth in the Scottish Government, told us:

    > "The core proposition is for us to establish a formal monetary union with the rest of the United Kingdom with the Bank of England operating as the central bank for sterling and so on, discharging its functions on behalf of both fiscal authorities in Scotland and the rest of the United Kingdom. Those functions would be on essentially price stability and financial stability."[65]

    He added: "The Bank of England is … the Bank of the whole United Kingdom … we would wish the Bank of England to continue [to be] lender of last resort to [Scottish] financial institutions."[66] We therefore concentrate in this chapter on the implications of this approach.

57. Rt. Hon Michael Moore MP, Secretary of State for Scotland, told us: "Our starting point is that the rest of the United Kingdom would keep the Bank of England and that would be for the rest of the United Kingdom's economy."[67]

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63 The Scotsman, Matter of no small change by Gavin McCrone, 28 February 2012

64 Q 626

65 Q 883

66 Q 884

67 Q 911

The UK Government's report *Scotland analysis: Devolution and the implications of Scottish Independence* says it would be

> "open to representatives of an independent Scottish state to seek to make use of arrangements now operative within the UK should they so wish, although any proposals would need to be considered carefully and may not be straightforward or necessarily in the interests of the continuing UK … Proposals for a formal currency union or for an independent Scottish state to have recourse to the Bank of England's functions could form part of independence negotiations should representatives of an independent Scottish state want to table them."[68]

58. **The position of both the UK and Scottish Governments on how an independent Scotland could retain sterling as its currency and what it would entail needs to be made clear. Both Governments have a duty to inform Scottish voters ahead of the referendum.**

Currency choice and monetary policy

59. The benefits of using sterling in a currency or monetary union are clear.[69] The avoidance of exchange costs, the elimination of currency risk, the continuation of existing contracts written in sterling and easier price comparison between products all minimise transaction costs and foster competition. The high degree of economic integration and mobility of capital and labour between Scotland and the rest of the UK is best maintained if they use the same currency.

60. If an independent Scotland used sterling, its monetary policy would continue to be determined by the Bank of England. While the Scottish and the rest of the UK economies remained similar there is no reason why they could not be both served by the same monetary policy. But if the two economies started to diverge, a single monetary policy would be less suitable. The ICAEW wrote:

> "From Scotland's point of view, there are major risks inherent in retaining sterling if Scotland is unable to influence the Bank of England's monetary policy. This is clearly a matter for negotiation, but Scotland's position would appear to be extremely unsatisfactory if it retains sterling but has no say in the Bank's monetary policy."[70]

61. Ms Johann Lamont MSP pointed out:

> "The MPC's composition can only be altered by amending existing legislation. This would be subject to the will of Westminster … Moreover, all of this neglects one important point, namely that the MPC was deliberately set up as an 'expert' committee, not one that represents geographical interests."[71]

62. **Effective governance of monetary policy requires the Monetary Policy Committee (MPC) of the Bank of England to continue to consist of**

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68 HM Government, Scotland Analysis, paragraph 3.37

69 To be clear on terms, currency union and monetary union both describe where two or more countries use the same currency. In a currency union there is usually one national central bank whereas in a monetary union there are several or a shared central bank (such as the ECB in the European monetary union). The UK Government refers to a currency union whereas the Scottish Government proposes sharing the Bank of England hence they refer to a monetary union.

70 ICEAW paragraph 17

71 Johann Lamont paragraph 59 and 62

experts. It would be unacceptable for the MPC to have members representing the interests of a separate country.

Currency choice and financial regulation

63. The Bank of England is responsible for the smooth running of the banking system, ensuring that payments between banks are made and received in a prompt and secure manner and for overall financial stability. The Bank manages liquidity and risk in the banking system under the Sterling Monetary Framework.[72] It has this role because, as Bagehot famously said, "Money will not manage itself."[73]

64. Mr Swinney, as noted in paragraph 56 above, clearly expressed the Scottish Government's desire to see the Bank of England continue to operate in an independent Scotland and be lender of last resort to Scottish financial institutions.[74] The Bank of England would also be responsible for "macroprudential regulation for the purposes of financial stability".[75]

65. Sir John Gieve, former Deputy Governor at the Bank of England, explained to us the functions of the Bank of England which might be involved.[76] There is a gradation of central bank functions depending on how much risk they involve to capital and therefore the taxpayers. Lender of last resort is intended to be a liquidity operation where funds are lent on the basis of good collateral and the institution is thought to be solvent. If an independent Scotland were a member of the EU and Scottish banks had branches which operated in the rest of the UK, the branches would have as much right to lender of last resort facilities as, say, the rest of the UK branches of a German bank, if they were seen as solvent. Moreover, that a Scottish parent bank had sterling assets for collateral would tend to make lender of last resort facilities for its branches in the rest of the UK less risky for the Bank of England. But such facilities would not apply to branches either in Scotland or overseas.

66. Mr Swinney has also stated that an independent Scotland would also need to set up a national financial regulator to meet EU requirements. He told us:

> "There would also be a requirement for micro-regulation in relation to the operations of financial services companies [based in Scotland]. Clearly, we would have to fulfil our obligations in that respect. We are anxious to ensure that that function is taken forward in a fashion that is as conducive as it possibly can be to the operational activities of the relevant financial institutions."[77]

Financial regulation in an independent Scotland would therefore be the responsibility of two regulatory bodies reporting to two Governments.

67. A separate Scottish institution set up to carry out prudential regulation of Scottish financial services companies would reduce the knowledge of the Bank of England in dealing with a counter party. The effects might be felt increasingly over time as regulations in Scotland and the rest of the UK

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72 The Sterling Monetary Framework describes the Bank of England's liquidity operations.

73 Walter Bagehot (1873), Lombard Street

74 Q 884

75 Q 888

76 QQ 918–920

77 Q 888

gradually diverged. Even though lender of last resort lends against high quality collateral, there is always some residual, perhaps operational, risk involved. The Secretary of State for Scotland said that the Government "would have serious doubts over wanting to provide the lender of last resort facility".[78] **For the Bank of England to provide central bank services to substantial financial institutions operating in an independent Scotland and regulated by a body reporting to an independent Scottish Government implies that the Bank would accept risks over which it had little control, which seems implausible.**

Bank of England governance

68. The Scottish Government's Fiscal Commission Working Group proposes a new governance structure for the Bank of England: an independent Scotland would become a shareholder of the Bank of England on the basis of population or output or a combination of the two (as with the European Central Bank).[79] Either would mean a Scottish shareholding of less than 10%. The Scottish Government would also have input into the appointment process of key positions and to the remit and objectives of the Bank.[80] The Working Group also recommends that a 'Macroeconomic Governance Committee' oversees matters which require coordinated input and/or agreement from both Governments. A representative from the independent Scottish Treasury could attend MPC meetings on a non-voting basis. Mr Moore told us: "Territorial representation on the MPC … is quite out of keeping with its primary purpose and the way it is convened at present … I am clearly not persuaded that would work or is desirable."[81]

69. **The Fiscal Commission's unprecedented proposal for the Bank of England to be overseen by both the rest of the UK and Scottish Governments would lead to significant governance and accountability problems. We do not see why the UK Government would agree to this proposal.**

Regulatory costs

70. Many Scottish financial institutions sell the bulk of their products to customers in the rest of the UK. For example, Scottish insurance companies sell over 90% of their policies in the rest of the UK.[82] Witnesses expressed concern at the prospect of a separate Scottish regulator in addition to the existing regulator for the rest of the UK. Mr David Nish, CEO of Standard Life, said: "I do not think that there is a working model [of cross-border regulation] that I can find."[83] He added: "The more you introduce complexity, the more likely it is that costs will increase."[84] Standard Life estimates its current regulatory costs for its UK business "are in the region of

78 Q 911

79 Fiscal Commission Working Group (2013), *First Report—Macroeconomic Framework,* p 184

80 *ibid.* p 185

81 Q 911

82 Q 571

83 Q 612

84 Q 617

£40m per year".[85] Mr Owen Kelly of Scottish Financial Enterprise agreed that additional regulation would incur additional costs.[86]

71. Mr John Cridland, Director-General of the CBI, expressed concern that different regulators might over time lead to diverging regulations and a segregated market. He said:

> "It is extremely difficult to separate out what are integrated businesses, where the biggest share of their business lies outside Scotland, whatever their historic routes or location decision … In one small island with those integrated businesses, the logic would be that there is a single financial regulator—not two financial regulators."[87]

A separate Scottish financial regulator may be a requirement for an independent Scotland to join the EU but it would be likely to add to compliance costs and complexity for Scottish financial institutions with large cross-border businesses.

Currency choice and the fiscal consequences

72. In rare circumstances the Bank of England may provide liquidity assistance to an institution outside the published Sterling Monetary Framework. This is known as Emergency Liquidity Assistance (ELA) and is typically extended to UK headquartered institutions thought to be solvent but known to be at risk. For example, in 2008 the Bank of England provided £61.6bn of secret emergency funding to RBS and HBOS.[88] Because ELA involves risk to the capital of the Bank of England if the institution fails, it requires authorisation from the Chancellor of the Exchequer to indemnify the Bank against losses which might arise, as was done in the case of RBS and HBOS. Since the Chancellor represents taxpayers' interests, ELA may be extended to UK headquartered institutions but not to foreign institutions.

73. Mr Swinney's proposals imply that an independent Scottish Government would wish the Bank of England to extend ELA support to Scottish institutions if needed. This would require the Chancellor of the Exchequer to put at risk taxpayers' money from the rest of the UK for the benefit of institutions based, and possibly regulated in, an independent country. Sir John Gieve summarised: "Is it conceivable that the UK Government could decide to, so to speak, leave things as they are—i.e., with an implicit guarantee or whatever? I would have thought that they would think very hard before doing that."[89]

74. For the rest of the UK Government to allow the Bank of England even to consider extending ELA to an institution based in an independent Scotland would require a prior undertaking by the Scottish Government to make good any losses. A simple promise would not be enough because the size of possible losses would be unknown. To safeguard the interests of its taxpayers the rest of the UK Government would want assurance that the funds could be repaid in a timely fashion. ELA to RBS and HBOS was equivalent to

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85 Standard Life

86 Q 617

87 Q 316

88 Bank of England, Additional information provided to the Treasury Committee by the Bank of England, 24 November 2009

89 Q 919

slightly more than half Scotland's GDP. Total state support to the two Scottish banks was equivalent to 211% of Scotland's GDP.

75. **It is difficult to see how the UK Government could extend central banking services to an independent Scotland since the UK Government would lack control over the tax and spending policies of an independent Scotland.**

Transitional risks

76. There are transitional risks in changing long-established currency and financial regulation arrangements. Dr Karen Henderson noted that the Czech-Slovak monetary union ended prematurely because of speculative capital movement and concerns about the Slovak budget deficit.[90] The union lasted only five weeks instead of the anticipated three years.[91] If a currency union is thought to be unsustainable capital may begin to flow from one member country to another. The British Academy wrote:

> "One important lesson from the way separation of [the Czech-Slovak] currency was handled relates to the prevention of bank runs: the anticipation of the devaluation of a currency can lead to rapid depletion of banks, as started to occur in Slovakia immediately on separation."[92]

They acknowledged, however, that a similar outcome might not necessarily occur in an independent Scotland.

77. **Continued use of sterling by an independent Scotland in monetary union with the rest of the UK is the stated preference of the Scottish Government. But it would raise complex problems of cross-border monetary policy, multiple financial regulators and taxpayer exposure and could only come about, if at all, on terms agreed by the UK Government. Arrangements should be clear before the referendum. But the proposal for the Scottish Government to exert some influence over the Bank of England, let alone the rest of the UK exchequer, is devoid of precedent and entirely fanciful.**

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90 Dr Karen Henderson paragraph 15

91 British Academy paragraph 31

92 *ibid.*

CHAPTER 4: SCOTLAND'S FISCAL POSITION

78. Independence would in principle allow the Scottish Government to run its own policy on taxation and spending. Mr John Swinney MSP, Cabinet Secretary for Finance, Employment and Sustainable Growth in the Scottish Government, told us that independence would create opportunities to "invest in growth", "support key industries" and "tackle key social issues" to "deliver the best results for Scotland".[93] This chapter addresses the question: to what extent would independence in practice give a Scottish Government the scope to develop a distinctive fiscal policy of its own?

79. Scotland's scope to develop a distinctive fiscal policy after independence depends on both its choice of currency and its share of current UK assets and liabilities. Since the intention of the Scottish Government is to continue to use sterling, as discussed in Chapter 3, the fiscal possibilities are discussed in this context. The principles for dividing the assets and liabilities were introduced in Chapter 2. North Sea oil and the public sector debt are the most important asset and liabilities and are discussed in more detail below.

North Sea oil and gas

80. The most important asset to be divided on Scottish independence would be the oil and gas reserves under the North Sea. The output is sold on world markets and the tax revenues are currently collected centrally by HM Revenue and Customs (HMRC). Over the past five years the average annual tax revenue from oil and gas has been £9.4bn. This represents only 1.7% of onshore tax revenues for the UK in 2011–12 but 20% of onshore tax revenues for Scotland.[94]

81. Professor Alex Kemp told us that the median line would be the starting point for negotiations between Scotland and the rest of the UK over division of North Sea oil and gas reserves. He thought that "there would not be too much controversy about that".[95] Most witnesses agreed that Scotland would gain approximately 90% of the oil and gas reserves.

82. The value of North Sea reserves depends on future exploration, investment, oil price, tax policy and decommissioning costs. Professor Kemp cited the most recent official estimates of the remaining reserves in the North Sea as between 10.3bn and 33bn barrels of oil equivalent.[96] His calculation of the oil tax revenues which might have accrued to Scotland from the UK Continental Shelf (UKCS) in past years is shown in Figure 1.

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93 Q 864

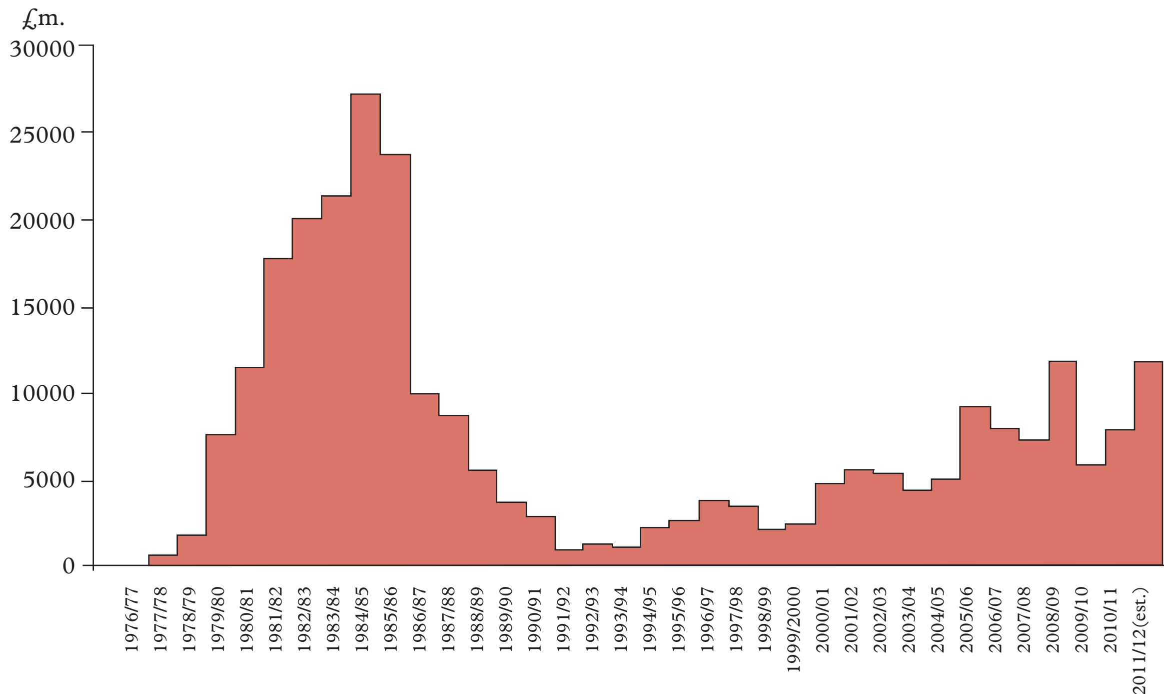
94 Government Expenditure and Revenue Scotland 2011–12, tables 4.1 and 2.3 and Office for Budget Responsibility, *Economic and Fiscal Outlook*, table 4.6, December 2012

95 Q 548

96 Professor Kemp paragraph 17

FIGURE 1

Hypothetical Scottish Royalty and Tax Revenues from the UKCS (£m at 2009/10 prices)



Source: Professor Kemp written evidence

Professor Kemp's 'guesstimate' (to which we referred in Chapter 2) is that net tax revenues in the Scottish sector could range between £5bn and £10bn per year for the next decade.[97] The revenue flows are large but volatile.

83. Volatility in the oil price translates into volatility of tax revenues. For example, between 2008/09 and 2009/10 North Sea tax revenues halved from £12.9 billion to £6.5 billion.[98] It is easier for a large nation than a small nation to absorb the volatility of oil revenues, as they constitute a very much smaller proportion of total tax revenues. Professor David Bell noted that the volatility of oil-based tax revenues makes "longer term planning for public services … pretty fraught".[99]

84. An independent Scottish Government would need to ensure a seamless transition to a new framework of licensing, taxation and health and safety provisions and so on for an industry employing directly and indirectly almost 200,000 people. Professor Kemp added that "investors and Government would have to think about it much more".[100]

85. **An independent Scotland would benefit substantially from tax revenues from a geographical share of North Sea oil and gas reserves. But, as the revenue from North Sea oil and gas would be a much larger proportion of total tax revenue in an independent Scotland than in the UK, its volatility would make it more difficult to conduct economic policy.**

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97 Q 553

98 Government Expenditure and Revenue Scotland 2011–12, table 4.3

99 Q 16

100 Q 550

Public sector debt

86. Our witnesses agreed that the UK's public sector debt should be shared by population. The most widely used measure of public sector debt is the Public Sector Net Debt (PSND) which was £1,104bn or 71.8% of UK GDP in the fiscal year ending in March 2012.[101] Assuming that 8.4% of this debt is allocated to Scotland (so the share is £93bn) and North Sea oil is allocated on a geographical basis, the ratio of Scottish debt to GDP would be approximately 61.6%.[102] The public sector debt to GDP ratio for the rest of the UK would be approximately 73.5%.

87. But this measure of debt does not include known future public sector liabilities. According to the Office for Budget Responsibility (OBR) these future liabilities for the fiscal year ending March 2011 include *inter alia*: £960bn of UK public service pensions; £32bn of UK private finance initiatives; and £108bn of other expected future liabilities (e.g. decommissioning nuclear power stations).[103] Ms Johann Lamont MSP argued that some of these future liabilities clearly relate to Scotland.[104] Assuming that these future liabilities are apportioned on the same population basis as the public sector debt, the total liabilities of an independent Scotland would double to £185.4bn or 123% of GDP including a geographical share of North Sea oil.[105] The UK currently has all of these future liabilities.

88. The Scottish Government aims for independence in March 2016. The OBR projects that the UK's public sector debt (PSND) will then be significantly larger, at £1,502bn or 85.1% of GDP.[106] This suggests that the public sector debt to GDP ratios for both an independent Scotland and the rest of the UK would be significantly higher than the figures for the fiscal year ending 2012 referred to above. If, however, economic growth were faster than projected, this prospective debt burden would lighten.

89. **We recommend that existing UK public sector debt should be apportioned between an independent Scotland and the rest of the UK by share of population. We also recommend that the UK's known future liabilities, such as public sector pensions and private finance initiatives, should be apportioned on the same population basis unless they can be clearly identified as applying to a particular nation only.**

Transfer of public sector debt

90. Transfer of an agreed share of the UK's public sector debt to an independent Scotland would not be straightforward. The terms on existing UK debt could not simply be altered to allow some to be owed by Scotland. This would constitute a meaningful change in contractual terms and would be a default. It would also take a newly-independent Scotland some time to establish a

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101 It is the total issued financial liabilities (government bills and gilts and National Savings debt) minus liquid assets (foreign exchange reserves and cash deposits) measured on a cash basis (so without accruals). This is an ONS statistic.

102 The Government Expenditure and Revenue Services report estimate Scottish GDP for 2011/12 including a geographic share of North Sea oil to be £150.9bn.

103 Office of Budget Responsibility (2012), *Fiscal Sustainability Report*

104 Ms Johann Lamont paragraph 6

105 Negative net balances on working capital and other assets (i.e. liabilities) may also have to be apportioned (depending on what they were used for) which would increase the liability figure further.

106 Office for Budget Responsibility (March 2013), *Economic and Fiscal Outlook*, Table 1.4

credit history successfully to issue enough debt to take on its share of the UK's liabilities. As Sir Nicholas Macpherson, Permanent Secretary of the UK Treasury, said: "Scotland will have to go into the market [and] it will not have the track record of the UK authorities, the sophistication of our debt management operations, or the extraordinary length of our yield curve, all of which means that it will face quite big risks."[107] Professor Bell noted that it was not clear how to assess the credit-worthiness of an independent Scotland in the absence of a credit history.[108]

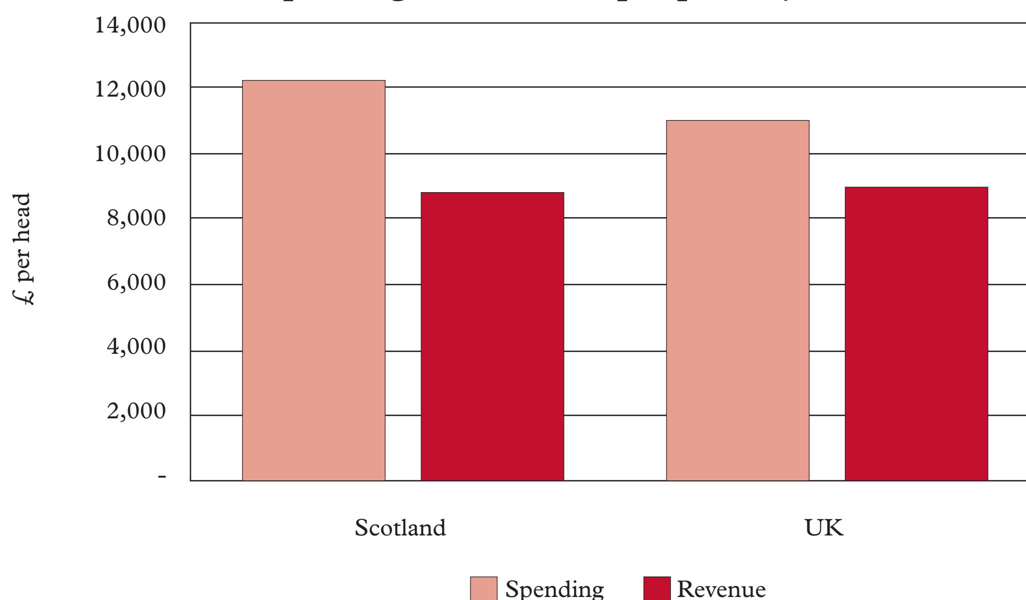
91. **Transferring to an independent Scotland its agreed share of UK liabilities would be fraught with difficulties. Creditors might not agree to a straight transfer of public debt from the UK to an independent Scotland on otherwise identical terms. The Scottish Government should explain to voters before the referendum how it would in practice take over its agreed share of UK public sector debt and future liabilities on independence.**

Scotland's 'separate' fiscal deficit

92. The Government Expenditure and Revenue Scotland 2011–12 (GERS) report provides a sketch of Scotland's fiscal accounts. The spending data mostly reflects actual spending in Scotland whereas much of the revenue data is imputed from UK data. Public sector spending per person, measured by total managed expenditure (TME), has been on average £1,160 higher in Scotland than the UK overall over the last five years. By contrast there has been little difference in reported tax revenue raised per person. This is shown in Figure 2 where the difference between the two bars is the fiscal deficit per person. In 2011–12 the deficit per person was £3,390 in Scotland and £2,052 in the UK. This is before any re-categorisation of North Sea oil and gas.

FIGURE 2

Public sector spending and taxation per person, 2011–12



Source: Government Expenditure and Revenue Scotland 2011–12

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107 Q 513

108 Q 7

93. The GERS report also presents an approximate fiscal balance for a separate Scotland. Without including any tax revenues or output from North Sea oil and gas, Scotland's separate fiscal deficit might be around £18.2bn or 14.6% of GDP in 2011–12. If, however, North Sea oil and gas revenues and output are apportioned on a geographic basis, as expected, the deficit for a separate Scotland might be £7.6bn or 5.0% of GDP in 2011–12. This is significantly lower than the OBR's estimate of the fiscal deficit (PSNB) for the UK overall of 7.9% of GDP in 2011–12. If the North Sea oil and gas output and tax revenue had been allocated to Scotland the fiscal deficit of the rest of the UK might be around 8.7% of GDP.

TABLE 1

Alternative measures of Scotland's fiscal balance

	2008–09	2009–10	2010–11	2011–12
Public sector spending (TME), £bn	59.0	62.0	64.0	64.5
Revenue, £bn	43.5	41.7	44.3	46.3
Fiscal balance, £bn	-15.5	-20.4	-19.7	-18.2
Fiscal balance, %GDP	-13.4%	-18.1%	-16.5%	-14.6%
Fiscal balance incl. NS oil, £bn	-3.7	-14.5	-11.7	-7.6
Fiscal balance incl. NS oil, %GDP	-2.6%	-10.7%	-8.1%	-5.0%
UK PSNB, % GDP	-6.9%	-11.2%	-9.5%	-7.9%

Note: Where North Sea (NS) oil is included in the table it is assumed that this is apportioned on a geographic basis.

Sources: Government Expenditure and Revenue Scotland 2011–12.

94. As things stand, most of the tax revenue is simply collected by HM Revenue and Customs (HMRC) and returned to Scotland as a block grant. GERS data do not therefore, represent amounts actually raised in Scotland. Instead they impute a large part of the revenue figures to Scotland from UK totals using a variety a methods. The Institute of Chartered Accounts of Scotland (ICAS) stated: "Let no-one be misled, there are no official statistics for tax paid by those in Scotland, simply because there has never before been a need to measure them."[109] ICAS also reported to us that "to design and implement an independent tax system in Scotland from scratch may realistically take a decade if not two, shorter if a more limited devolution of powers is involved".[110] If Scotland becomes independent the taxes paid in Scotland would no longer transfer to HMRC but remain in Scotland. The block transfer to Scotland would cease to exist. Professor John Kay said: "There could be no continuing transfer of this kind [the block grant] and Scotland would have to finance its activities from its own revenues."[111] Whether this might involve tax increases or reductions can only be determined once it becomes clear what the actual tax yield is for Scotland.

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[109] Institute of Chartered Accounts of Scotland question 3

[110] *ibid.* question 6

[111] Q 65

us: "It was actually France and Germany that drove a coach and horses through that [the stability and growth pact], which demonstrates … who calls the shots in Europe."[121]

102. Some witnesses thought an independent Scotland would retain some room for manoeuvre over the composition of taxation. Mr Jeremy Peat of the David Hume Institute said: "There is a great deal of ability to vary individual taxes and indeed to operate the public finances independently, subject to an overarching constraint or two as to the overall fiscal position and the sustainability of that position."[122] Mr Swinney made clear the Scottish Government's interest in having the power to vary corporation tax as a means to promote economic growth.[123]

103. Professor Kay warned that within a single market "there are some areas where competition is destructive and corporation tax is one example".[124] Professor Gallagher agreed: "There is a general view and understandable principle that varying any taxation is a distortion of market activity. Varying tax across the territory is a greater distortion."[125]

104. **A monetary union as advocated by the Scottish Government would require robust and credible limits on borrowing and indebtedness by both member states. So far the Eurozone has found this problem intractable. The Scottish and UK Governments would need to reach agreement on detailed and credible fiscal restraints, including sanctions for breaches, before the referendum if Scottish voters are to make an informed choice. We believe that it would be difficult for any such agreements to be made binding in all circumstances.**

105. Currency and fiscal unions offer scope for risk sharing between the nations in the union. The British Academy stated: "As is the case with federations such as the United States, automatic stabilisers and risk sharing measures are part of the UK's current fiscal system. In the event of a local shock, tax revenue goes down and social security payments go up, thus cushioning the shock. These would be lost by an independent Scotland, and thought would have to be given to how they could be replaced."[126]

106. Mr Alexander also drew attention to the UK's automatic fiscal stabilisers, for example transfer payments through the welfare system, which cushion regional impacts. He said: "Those transfers would not be available in the context of an independent Scotland."[127] **Dismantling the current fiscal union would result in a loss of risk-sharing mechanisms between an independent Scotland and the rest of the UK. This would be an adverse consequence for the citizens of both states, but particularly for people in Scotland given the relative size of the two countries.**

107. **With no track record of issuing debt securities, the difficult mechanics of taking on a share of the UK's public sector debt, volatile tax revenue and the loss of risk-sharing with the rest of the UK, an independent Scotland would face considerable fiscal challenges.**

[121] Q 566
[122] Q 536
[123] Q 898
[124] Q 108
[125] Q 629
[126] British Academy paragraph 20
[127] Q 503

111. **The Scottish Government's commitment to EU membership for an independent Scotland recognises the economic importance of the single market and the need of Scottish business to remain part of it. But it is not clear how Scotland would make the transition from its current inclusion in an EU member state to EU membership as a state in its own right, since there is no precedent in EU history.**

112. We asked the President of the European Commission, Mr Jose Manuel Barroso, for guidance on the processes which would apply in a first case of transition by a part of an EU member state to full membership of the EU as an independent state in its own right.[133] He replied:

> "A new independent state would, by the fact of its independence, become a third country with respect to the EU and the Treaties would no longer apply on its territory … any European state which respects the principles set out in Article 2 of the Treaty on European Union may apply to become a member of the EU. If the application is accepted by the Council acting unanimously, an agreement is then negotiated between the applicant state and the Member States on the conditions of admission and the adjustments to the Treaties which such admission entails. This agreement is subject to ratification by all Member States and the applicant state."[134]

113. Mr Swinney disputed Mr Barroso's analysis. He said: "There is no provision within the Treaty on European Union that provides for the scenario that President Barroso has cited."[135] Asked if the Scottish Government would put clearly to the Scottish electorate that there is a strong possibility that an independent Scotland would have to reapply for membership of the European Union, Mr Swinney replied: "No, we will not do that."[136] He added that the European Commission had made clear that "it would only ever comment on a specific scenario if requested to do so by a member state. The United Kingdom Government have made it clear that they would not be prepared to do so".[137] But he clearly expects the United Kingdom actively to assist a transition after a "Yes" vote in 2014, citing clause 30 of the Edinburgh Agreement: "The two governments are committed to continue to work together constructively in the light of the outcome, whatever it is, in the best interests of the people of Scotland and of the rest of the United Kingdom."[138]

114. **Taking as authoritative the view on process of the President of the European Commission, the European Treaties would cease to apply to Scotland on independence. Scotland would need to apply for membership of the European Union in its own right and the outcome of negotiations on Scotland's admission would need to be ratified by each EU member state.**

115. An independent Scotland's transition to membership of the EU would raise complex issues of substance as well as of process. For example, the European

[133] Lord Tugendhat's letter of 29 October 2012 to the President of the European Commission

[134] Mr Jose Manuel Barroso's reply of 10 December

[135] Q 865

[136] Q 876

[137] Q 878

[138] Q 864

> to have a double contributions agreement for things such as national insurance, and we would probably need an agreement for inheritance tax as well. So we would need a fairly comprehensive set of agreements covering a wide range of taxes."[142]

120. Scotland would also "have to start negotiating new treaties with other jurisdictions … it will be a long process, I would have thought, for Scotland to put together a set of international tax treaties".[143] Extra costs for Scottish business would result, as Mr Soames fears:

> "One of the big impacts and complications for us as a global business will be around double taxation agreements. The people who will have a ball with independence are all the professional advisers—all the accountants and lawyers."[144]

121. **An independent Scotland would need to have a double taxation agreement with the rest of the UK and to negotiate tax treaties and similar agreements with a range of countries.**

142 Q 413

143 Q 413

144 Q 797

"The UK Government position is clear: Scotland benefits from being part of the UK and the UK benefits from having Scotland within it. The UK Government are not making plans for independence as we are confident that people in Scotland will continue to support Scotland remaining within the UK in any referendum.

"In the run-up to the referendum the UK Government will produce detailed evidence and analysis to assess the benefits that Scotland gains from being part of the UK and the contribution that Scotland makes to the UK. As one of the major reserved areas, Defence will feature significantly in this work …

"No work has been undertaken to estimate the cost of replicating the facilities at Faslane and Coulport at another site in the UK. It is clear from first principles, however, that the cost of relocating such facilities from Scotland would be extremely high.

"I am withholding information relating to contingency planning arrangements should Her Majesty's Naval Base (HMNB) Clyde become inoperable for the purpose of safeguarding national security."[147]

The then Minister of State for the Armed Forces also told the Scottish Affairs Committee of the House of Commons that replicating the Clyde facilities elsewhere in the UK would "cost a gargantuan sum of money" dwarfing the £3.5bn spent on upgrading the Clyde base.[148]

The Secretary of State for Defence, writing later to reaffirm his unwillingness to give us oral evidence, added: "Any alternative solution would come at huge cost … Any replication of … facilities would cost at least that much and probably more [than the recent £3.5 bn investment programme at HMNB Clyde in 2011–12]."[149]

The MoD later wrote to the Scottish Affairs Committee: "As the UK Government has no plans to unilaterally disarm, there would inevitably be time and cost implications if an independent Scottish Government demanded the withdrawal of the UK deterrent. The UK Government will not pre-negotiate the departure of Scotland from the UK. Therefore scenarios mentioned in the [Scottish Affairs] Committee's report under which the UK may negotiate a basing agreement for the deterrent with an independent Scottish Government will not be discussed prior to the outcome of the referendum."[150]

132. **We were disappointed by Defence Ministers' refusal to attend a hearing and answer our questions. In defence, as in other areas, facts are lacking to help Scottish voters make an informed decision, and the rest of the UK to understand the implications. The Government should take every chance to make things clearer. Its acknowledgment of time and cost implications if an independent Scotland demanded the withdrawal of the UK deterrent is a step in the right direction. But there is a long way to go.**

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[147] Hansard, 4 July 2012, cols. 680W–681W

[148] Scottish Affairs Committee: *The Referendum on Separation for Scotland: Session 2012–13, oral and written evidence* (HC Paper 139-I), Q 326

[149] Letter of 22 November 2012 to Lord Tugendhat from Rt Hon Philip Hammond MP

[150] *The Referendum on Separation for Scotland: Terminating Trident – Days or Decades?*: Government Response, published 9 January 2013 (HC Paper 861)

nuclear issue”.[168] In Mr Paul Ingram’s view, the SNP’s policy that an independent Scotland in NATO would not take part in out-of-area operations without UN endorsement is a valid position within NATO rules.[169]

146. An independent Scotland would be responsible for its own defence. It would need to devise a new national defence policy, making its own assessment of possible threats to national security and setting defence priorities. As well as negotiating with the rest of the UK a division of assets and liabilities in defence as in other areas, it would need to decide whether to apply to join NATO and what resources in money, personnel and equipment to devote to defence. In addition to their strategic importance, these decisions would make a significant impact on employment and on the wider economy in Scotland.

147. Professor Gallagher told us:

> “An independent Scotland would have a different set of defence requirements from those of the rest of the UK. You could be very unkind and say that those would be very small—that there would be a kind of Home Guard approach. Or you could say that they might more resemble those of Ireland than, say, Denmark, to take two slightly contrasting examples. Whatever they were, they could not conceivably be an attempt to project power on a scale or at the distance that the rest of the UK currently does.”[170]

148. Professor Malcolm Chalmers, Research Director at the Royal United Services Institute, wrote:

> “An independent Scotland’s annual defence budget … seems unlikely to exceed 1.4% of GDP, or around £2 billion (at 2011/12 prices). It may even be significantly less, were Scotland to follow the low-spending route followed by Ireland, which is similarly protected by geography from external military threats, or newly-created states (such as Lithuania and Latvia) which have sought to create armed forces from scratch. These three countries spend, respectively, 0.6%, 0.8% and 1.0% of their GDP on defence.” [171]

149. Professor Chalmers also wrote:

> “If … the rest of the UK were to seek to maintain a defence capability comparable to that of the UK, it would be likely to want significantly more than the 91.6% of total assets which strict population share would suggest. It would, moreover, want to keep almost all existing inventory of major high-value equipment … If Scotland were to take only 5% of total MoD net assets, it could argue that it was entitled to financial compensation (amounting to some £3.6 billion) in return for receiving less than its population share. Demands for such compensation would have to be part of a wider, and complex, negotiation on the division of UK assets and liabilities. Scotland’s reduced share in defence assets could, for example, provide it with a bargaining chip if it decided to seek a reduction in its share of the inherited national debt.

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[168] Q 738

[169] Q 446

[170] Q 632

[171] Malcolm Chalmers, RUSI

"The rest of the UK could argue, for its part, that it would be entitled to compensation for any additional defence spending which it had to incur as a result of a separation that it did not seek … If Scotland were to insist on these units [submarines and military aircraft still part of the rest of the UK's armed forces] being relocated to the rest of the UK, the rest of the UK could argue that the costs of such a move should be funded by Scotland …

"By contrast, if most Royal Navy and RAF units based in Scotland were to remain there under the rest of the UK control, the rest of the UK could not reasonably claim compensation. Were their bases now to become the property of the Scottish Government, the latter might feel entitled to charge an economic rent for the property being used. Alternatively, the two parties might prefer to keep these facilities (including the infrastructure at Faslane and Coulport that supports the UK nuclear force) under the rest of the UK ownership. Were this to be the arrangement, Scotland's compensation might instead be subsumed within the wider calculus of how UK assets and liabilities are divided."[172]

150. Professor Chalmers also provided an illustrative table:

TABLE 2

Possible outcome of Separation on Defence Budgets and Assets (based on 2011/12 levels)

2011/12	Actual UK	Notional Scotland	Notional the rest of the UK
Defence Spending: Population share	£38 billion	£3.2 billion	£34.8 billion
Defence Spending: Estimated Defence Requirements[173]	£38 billion	£2 billion	£38 billion
Defence Assets: Population Share[174]	£107 billion	£8.9 billion	£98.1 billion
Defence Assets: Estimated Defence Requirements[175]	£107 billion	£5.3 billion	£101.7 billion

Source: Professor Chalmers written evidence

[172] Malcolm Chalmers, RUSI

[173] This assumes that the rest of the UK seeks to maintain the current UK level of defence spending, and that Scotland spends around the same proportion of GDP on defence as Denmark and Norway. Under this scenario, the total amount spent on defence in the two states therefore exceeds the amount that would have been spent if the UK had remained as a single state.

[174] Assets as of 31 March 2011. *UK Ministry of Defence Annual Report and Accounts 2010–11*, July 2011, p. 105

[175] Assets divided in proportion to post-separation defence budgets

151. **There is not enough information about the defence policy of an independent Scotland to enable Scottish voters to make an informed judgment in next year's referendum. We recommend that the Scottish Government should make a sustained effort to clarify the issues before the vote, giving an indication of its expected defence budget, military establishment, scale of procurement and impact on Scotland's workforce skills base, as well as indicating the terms of Scotland's application to join NATO. This would help Scottish voters assess the employment and economic as well the security implications of an independent defence policy.**

196. We invite the Ministry of Defence to publish its estimates of the overall cost implications for the rest of the UK of a division of conventional military assets with Scotland on the lines suggested by Lord West. (Paragraph 139)

197. Lord West suggested to us that defence-related job losses in an independent Scotland could range up to 25,000. If they were realised, they would represent an unwelcome transitional effect of independence. (Paragraph 144)

198. There is not enough information about the defence policy of an independent Scotland to enable Scottish voters to make an informed judgment in next year's referendum. We recommend that the Scottish Government should make a sustained effort to clarify the issues before the vote, giving an indication of its expected defence budget, military establishment, scale of procurement and impact on Scotland's workforce skills base, as well as indicating the terms of Scotland's application to join NATO. This would help Scottish voters assess the employment and economic as well the security implications of an independent defence policy. (Paragraph 151)

* The Institute of Chartered Accountants in England and Wales (ICAEW)

* The Institute of Chartered Accountants of Scotland (ICAS)

** The Institute of Directors (IoD)

** The Institute for Fiscal Studies

** Institute for Public Policy Research (IPPR North)

** Professor Charlie Jeffery

** Professor John Kay

* Professor Alex Kemp

* Johann Lamont MSP

** Sir Nicholas Macpherson, Permanent Secretary to the Treasury

** Professor Gavin McCrone

* Dr Iain McLean FBA FRSE, Professor of Politics, Official Fellow, Nuffield College

** Rt Hon Michael Moore MP

** National Farmers Union of Scotland (NFUS)

Newcastle International Airport Ltd

** Reform Scotland

** Willie Rennie MSP

* Professor Robert Rowthorn

** Royal Bank of Scotland

** Scotland Office

** Scottish Chambers of Commerce

** Scottish Financial Enterprise

** The Scottish Institute of Directors

Scottish and Southern Energy (SSE)

** Scottish Trades Union Congress (STUC)

** Professor John Simpson

* Standard Life

** John Swinney MSP

** Professor John Tomaney

** Weir Group

** Lord West of Spithead

independent Scotland require fiscal rules to limit risk exposure? Would they work?

(4) Economic structures, cycles and flexibility

(a) Would the economies of the rest of the UK and an independent Scotland be likely to diverge or remain similar? If diverge, how would this affect the rest of the UK? Would economic cycles converge or diverge and what would be the consequences?

(b) Would independence for Scotland affect its trade / current account balance with the rest of the UK? What would be the consequences? Could non-tariff trade barriers emerge over time?

(c) Would there be more movement of large company/financial institution headquarters from/to an independent Scotland and the rest of the UK? Would Scottish independence have any impact on labour markets across the UK?

(d) What would be the impact on other parts of the UK if an independent Scotland were not flexible enough to respond to an economic shock? Does the rest of the UK adjust more or less rapidly to shocks than Scotland?

(5) Lessons from other countries

(a) Are there lessons from the experience of previous separations, such as Irish independence in 1922 and the break-up of Czechoslovakia in 1992, or where separation has been advocated, as in Spain and Canada?

TABLE 3

Key figures on Scotland and UK economies. North Sea oil and gas excluded from output figures except for the UK marked *

	Scotland	UK
Population-2011 (million)[178]	5.3m (8.4% of UK)	63.2m
Output-2011 (£ billion)[179]	£108bn (8.1% of UK)	£1,341bn
Output per head-2011 (£)[180]	£20,571	£20,873
Price level index-2010[181]	99.7	100
Unemployment-October to December 2012 (%)[182]	7.7%	7.8%
Average weekly earnings-2012[183]	£498	£506
Productivity-output per hour worked index for 2011[184]	96.9	100
Trade-2011 (% of output)[185]	37% (excluding trade with the rest of the UK) 105% (including trade with the rest of the UK)	67%*
Public sector spending-2011–12 (% of GDP)[186]	52%	46%*

Scotland is a very open economy when trade with the rest of the UK is added to that with the rest of the world. While the trade and GDP data for Scotland should be treated with caution—the data for Scotland is "experimental" and excludes North Sea oil and gas output whereas the data for the UK includes North Sea oil and gas—the overall picture is clear. For Scotland trade with the rest of the UK is a huge part of its economy representing almost two-thirds of its total trade and worth an estimated 68% of output. But for the rest of the UK trade with Scotland

[178] ONS, *2011 Census: Population estimates for the UK*, 17 December 2012

[179] Output measured by GVA. ONS, *Regional Gross Value Added (Income Approach)*, 12 December 2012

[180] Output measured by GVA. ONS, *Regional Gross Value Added (Income Approach)*, 12 December 2012

[181] ONS, *UK Relative Regional Consumer Price Levels for Goods and Services for 2010*, 12 July 2011

[182] ONS, *Labour Market Statistics*, 20 February 2013

[183] ONS, *Annual Survey of Hours and Earnings, 2012 Provisional Results*, 22 November 2012

[184] Output measure used in GVA. ONS, *Labour Productivity, Q 3 2012*, 3 January 2012

[185] Expressed as the sum of exports and imports as a percentage of GDP. Scotland data is from Scottish National Accounts Project, *Scottish National Accounts Tables*, Table 8, 2012 Q2; UK data is from ONS, *Quarterly Accounts*, C1, Q3 2012

[186] Scottish Government, *Government Expenditure & Revenue Scotland 2011–12*, Box 2.3, March 2013

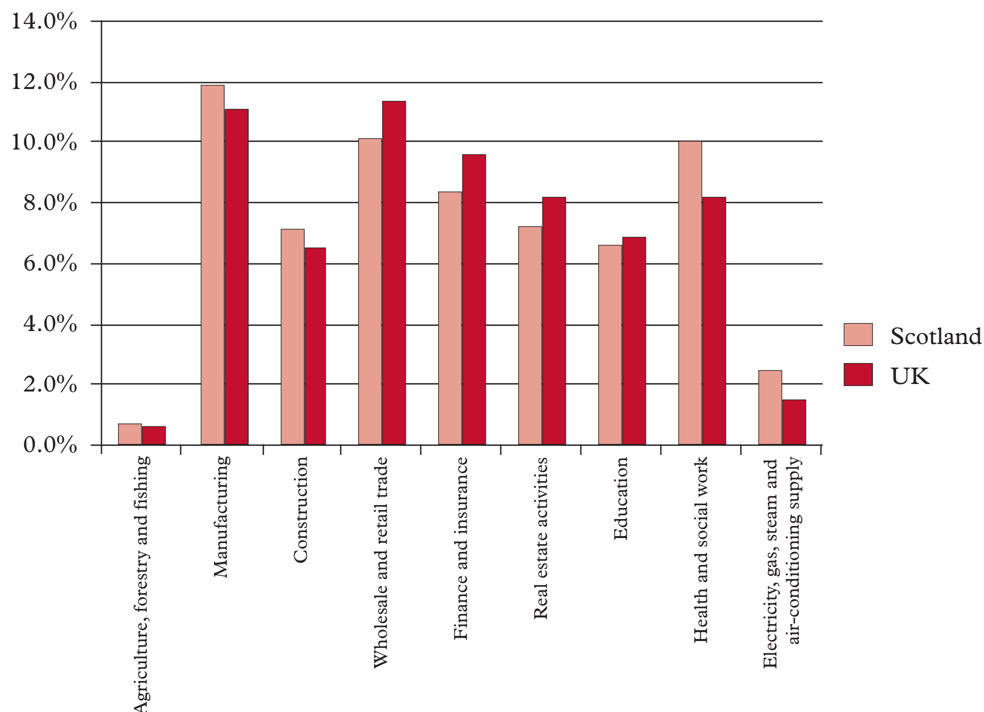
is a much smaller share of its economy—around 6% of its output.[187] Trade linkages between Scotland and the rest of the UK are particularly strong in financial services. Scottish insurers sell 6% of their products there and 94% to the rest of the UK. About 16% of mortgages sold by Scottish firms are to Scottish postcodes and 84% to the rest of the UK.[188]

Public sector spending, however, is a considerably higher share of Scotland's output. Again there is a note of caution in using this data as the ratio for Scotland excludes any North Sea oil and gas output while the ratio for the UK includes North Sea oil and gas output. Public spending in Scotland is underpinned by the Barnett formula which was introduced in 1978 and allocates substantial parts of government spending between the four nations of the UK.

Manufacturing and construction make up more of Scotland's economy than the whole UK, with the reverse true for financial services, real estate and wholesale and retail trading. But the differences are relatively small as the chart below shows. North Sea oil and gas would likely make a significant contribution to an independent Scotland's economy but this is not included in the chart below. These similar economic structures and strong trade linkages lead Scotland and the rest of the UK to share similar business cycles.[189]

FIGURE 5

Key sectors in Scotland and the UK economies (% of output*)



**Output measured by Gross Value Added (GVA).*

Source: ONS, Regional Gross Value Added (Income Approach), Regional GVA NUTS1, Table 1.3, 12 December 2012

[187] Figures calculated from The Scottish National Accounts Project, Scottish National Accounts Tables, Table 8, 2012 Q2; UK data taken from ONS, Quarterly National Accounts, Q 3 2012, Table C1, 21 December 2012

[188] Q 515

[189] For an assessment of the similarity of business cycles see National Institute Economic Review, January 2012, Scotland's Currency and Fiscal Choices by Angus Armstrong.

TABLE 4

Countries similar in size to Scotland

	Scotland	**Denmark**	**Finland**	**Ireland**	**Norway**	**Sweden**	**Switzerland**
Population	5.3m	5.5m	5.4m	4.5m	4.9m	9.4m	7.8m
GDP (PPP)	$181.5bn	$219.3bn	$196.6bn	$178bn	$277bn	$365.9bn	$361.9bn
GDP per heard (PPP)	$34,754	$39,545	$36,664	$39,778	$56,648	$39,013	$46,480
Public sector debt	82.4% (UK figure)	55.5%	57.4%	102.4%	49.5%	49.1%	40.2%
Tax on average worker (% of labour cost)	32.7% (UK figure)	38.3%	42%	29.3%	36.8%	42.7%	20.8%
Currency	Sterling	Danish Krone	Euro	Euro	Norwegian Krone	Swedish Krona	Swiss franc

Note: GDP figures are based on Purchasing Power Parity (PPP) exchange rates to give the sum value of all goods and services produced in the country valued at prices prevailing in the United States.

Source: Except for Scotland all data taken from OECD, Country Statistical Profiles: Key Tables from OECD for the year 2010; for Scotland population is from ONS 2011 Census; 2010 GDP figure taken from The Scottish National Accounts Project and divided by the UK's PPP rate taken from OECD (2010 population used for GDP per head).

Scotland to any fixed timetable for euro zone membership but a clear commitment to joining would be required as there is no reason to believe that an opt-out would be negotiable.

Mr John Swinney MSP, Cabinet Secretary for Finance, Employment and Sustainable Growth in the Scottish Government has stated that he "cannot foresee circumstances in which an independent Scotland would want to join the euro."[203] In the near term this is likely to be the case. The third requirement for joining the euro (along with an independent currency and a central bank) is meeting the so-called convergence criteria or Maastricht criteria. On any reasonable division of assets and liabilities it seems unlikely that an independent Scotland would, according to Professor Kay, meet the:

> "criteria on the kind of envelope numbers one would have from an independent Scotland, so that would not arise as an immediate issue. I also suspect there is a lot less inclination on the part of people in Europe to bend the rules in favour of letting additional countries into Europe now."[204]

The structure of the European Monetary Union is however changing significantly. There are clear plans to move towards closer political and fiscal integration with a single bank regulator and possibly a common deposit insurance scheme. If Scotland were eventually to join the euro zone it would have a seat on the European Central Bank by right and have an equal vote with all other members. This would avoid the difficult governance issues with the UK government over the Bank of England which would arise if Scotland keeps sterling as its currency. Over time euro zone arrangements may become more agreeable than the alternative choices.

Professor McCrone raised doubts about whether an independent Scotland could maintain its competitiveness within the euro zone:

> "Monetary unions only work if inflation is at broadly comparable rates between the member states … Countries with their own currencies can restore competitiveness by devaluation, but within the euro zone this is impossible … Certainly Scotland would be wise not to join the euro, at least if there is any doubt at all about its ability to maintain the competitive position of its economy against other euro zone countries."[205]

However, the case of Ireland may yet show that realigning competitive positions may in fact be possible, albeit at some price.

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[203] Q 887

[204] Q 67

[205] Gavin McCrone, Matter of no small change, The Scotsman 28 February 2012