Summary

Much cost, little benefit

The economic consequences of Scottish separation

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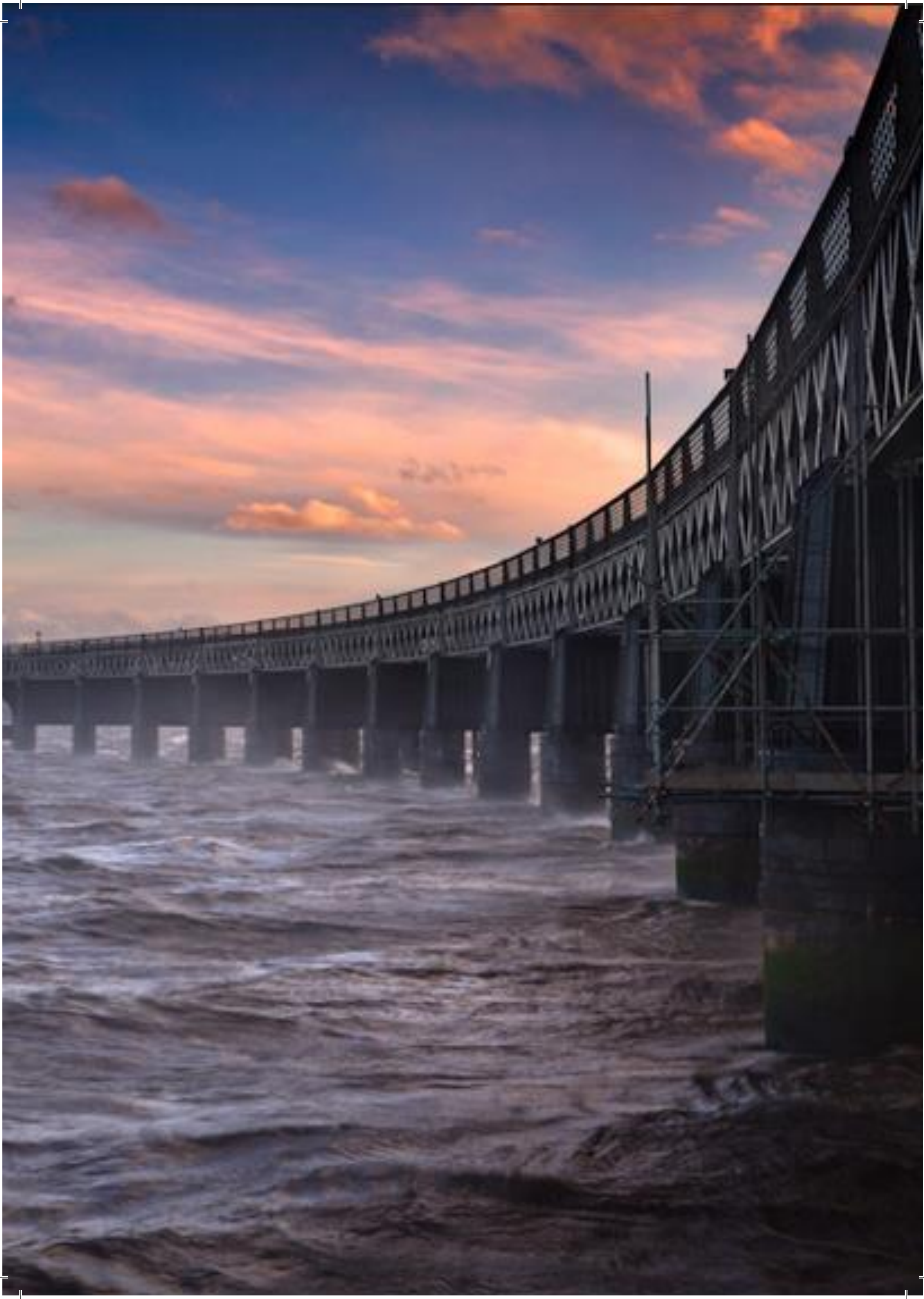
SCOTTISH RESEARCH SOCIETY



Much cost, little benefit

Economic consequences of Scottish separation

Ewen Stewart, Walbrook Economics

- The economic arguments against separation are overwhelming.
- A majority voting Yes would almost certainly end the Union.
- The heavy costs of separation have not been thought through.
- If Scotland met EU borrowing rules, separation might cost each household £3400-5500 a year, plus higher mortgage interest.
- The Scottish Government's "white paper" is a vague and uncosted wish-list.
- As a separated country, Scotland would quickly need to address its fiscal deficit.
- To base prosperity and public spending choices on volatile future oil revenues is imprudent.
- The lack of clarity about the form of the final settlement is a major risk factor deterring investors.
- Uncertainties following a Yes vote would harm investment, confidence and economic performance.
- The economies of Scotland and the rest of the UK would still be interlinked even after separation.
- Scotland has more independence in the UK than outside it.

Too much spending, too little revenue

- In 2012/13, Scotland raised £48.11bn in tax receipts, including £552m as its per-capita share of oil revenues, and spent £65.2bn, running a fiscal deficit of £17.1bn, or £3226 for every man, woman and child.

- Scottish public spending cannot be £3000 per household higher than the UK average when Scottish gross value-added is little more than nine-tenths of the UK average.

- Scottish government data show that with or without oil Scotland's fiscal position is one of Europe's weakest.

  A separated Scotland cannot survive without heavily cutting public spending or greatly raising taxation, or probably both. Public-sector salaries, State-funded pensions, welfare and disability payments, health and education – all will be at risk of severe cuts if Scotland decides to separate from the UK

- A separated Scotland would be one of the most cyclical, volatile and high-risk economies in Europe.

- Public spending in Scotland, relative to the size of the economy, has been consistently and substantially greater than in the UK as a whole.

Scotland's currency – Hobson's choice

- Keeping Sterling is overwhelmingly in Scotland's interests given pension, trade and savings flows. The Scottish Government has no credible plan to address the key issue of currency choice.

- Scotland, given its current assets and liabilities, cannot adopt Sterling informally without a substantial risk of asymmetric economic shocks. Informal currency union with England is nothing more than a short-term fix with long-term dangers.
- The Scottish administration's current proposals for an informal adoption of Sterling do not constitute independence: it would be forced to pay the piper, but also forced to let the piper pick the tune and then to dance to it.
- It would make little sense for Scotland to adopt the euro. The eight economic-convergence criteria for adoption of the euro laid down in the Treaty of Maastricht were abandoned when the European Commission, in its pre-changeover assessment, discovered that only Luxembourg complied with them. The euro is a risk.
- Scotland's trade is overwhelmingly with the rest of the UK. Eurozone growth remains weak with highly divergent levels of unemployment between the member-states. Scotland would have virtually no influence on setting Eurozone monetary policy.

The national debt – a heavy burden

- A separated Scotland would take on a national debt of £116bn and rising, or £186bn with bank liabilities.
- Repudiation of Scotland's share of the UK national debt may seem tempting but would fatally damage Scotland's international reputation for fiscal trustworthiness.
- At a conservative estimate, Scotland would pay an initial risk premium of 0.5-1% over UK gilts if it wanted to borrow. If

Scotland did not adopt a disciplined approach, this risk premium might widen materially.

Oil and gas – not a get-out-of-debt-free card

- In 2012, even if Scotland secured a per-capita share of North Sea oil, its annual deficit would have been 13.3% of GDP. Only Greece and Slovenia were in a weaker position.

- If a separated Scotland got its per-capita share of oil revenues and adhered to the Maastricht national-debt limit, tax hikes or spending cuts would be £13bn – almost £2500 per head, or £5400 per household, and more than Scotland's entire health budget in 2012/13.

- The Office for Budget Responsibility has cut its projection of oil tax revenues to 2040 by almost a quarter. Oil revenues, and hence Scotland's, are highly cyclical and unpredictable.

- Scottish oil production is in structural, long-term decline, reserves are falling, extraction costs are high and the price of the underlying commodity value highly volatile. Oil is great to have but it is no panacea, and no sound basis for long term economic prosperity.

- Price volatility and dwindling oil reserves mean the Scottish Government cannot rely on oil revenues for meeting its heavy obligations to pay for pensions, welfare, health and education.

The banks – too big to succeed, too big to fail

- In a separated Scotland a population of 5.3 million generating only £129bn of GDP could not support the current liabilities of the Scottish banks, which equate to 12 times GDP, compared with Irish liabilities of less than 8 times GDP and UK liabilities of 5.5 times GDP.

- Should Scotland separate and lose the protection of the Bank of England, Scottish banks would be faced with the stark choice of either relocating the vast majority of their assets and their legal jurisdiction and headquarters to London or shrinking their balance sheets precipitously.

- It is no exaggeration to say that if Scotland had been independent, the financial crisis of 2008 would have been a national calamity no less severe than that which followed the Darien venture.

- On the basis of its banks' market capitalisation, a separated Scotland in 2008 would have been in the basket-case basket with Iceland, Cyprus, Greece and Ireland. Those who seek separation simply have not thought through, still less addressed, the consequences of their proposed actions.

Trade – a heavy dependence on the UK

- The trading relationship between Scotland and the rest of the UK is asymmetric. Scottish exports to the rest of the UK account for 39.1% of Scottish GDP. Exports from the rest of the UK to Scotland account for just 4% of the rest of the UK's GDP. Scotland is highly dependent on the rest of the UK as a home for its goods.

- While Scotland would have the protection of the World Trade Organisation, by separation it would make itself needlessly vulnerable to changes in the terms of the rest of the UK's trade with it. Scotland would not be in any useful sense independent: merely expensively and pointlessly separated.

- Exports to the rest of the UK account for a staggering 70% of all Scottish exports. It would be unwise to jeopardise Scotland's largest export market, which is so critical to employment and the wealth of the nation.

Government and finance: Scotland's big two

- Just over half the Scottish economy is accounted for by two sectors: government and financial services.
- Financial services might be expected to emigrate from Scotland in the aftermath of separation.

Scotland's declining population share

- While Scotland's population over the next 20 years will grow, that rate of growth will continue to lag the rest of the UK as it has in the recent past.
- Scotland's ratio of workers to dependents continues to decline at a faster rate than elsewhere in the UK.

European and global implications of separation

- The Scottish Government's assumption that Scotland would automatically be admitted to the EU on leaving the UK is not shared either by the European commission or by many member states.

- The Scottish Government's retort that it would retaliate against the EU if membership were not granted does not seem a credible response. Scotland would be in a very weak position to dictate terms, given its lack of economic muscle and its tiny population of 5.3 m, little more than 1% of the EU's population of 503 m.

- Scotland would be unlikely to secure an opt-out from adopting the euro, as part of the price of joining the EU.

- The process of agreeing terms for Scottish EU membership could well take years.

- The EU, while important, is in structural decline. Real power remains with the US and, increasingly, the East.

- The impact of a refusal on the part of the EU to permit Scotland, as a member state, to continue to enjoy the UK's VAT opt-outs would fall disproportionately on low-income households, of which Scotland has many.

Scotland in the wider world

- The UK is a permanent member of the UN Security Council, a founder member of NATO and an influential voice in almost every significant international organisation. Scotland would not be anything like so influential.

- According to the IMF, the Scottish economy would rank 47th in the world, sandwiched somewhere between Kazakhstan and Algeria.

- In an uncertain world, the splitting of the hitherto politically stable UK would be seen as a profound event. It would raise questions about the UK's safe-haven status.

Energy and climate change – a costly policy

- The dash for renewables is increasing Scotland's energy costs. Government subsidies to the renewables sector are already amongst the highest in the world and are not sustainable, leaving Scotland highly vulnerable in terms of economic efficiency and beholden to the rest of the UK for export pricing.

- Economic studies have shown that the cost of measures to forestall global warming today is typically greater, and can be 10-100 times greater, than the cost of permitting global warming to occur.

Defence and diplomacy: guarantors of security

- The proposed "Scottish Defence Force", whose suggested initial budget has already been cut twice, is not a credible answer to the many threats that Scotland would face.

- In reality, a Scottish force would be little more than a token peacekeeping force doing the bidding of the EU or the UN. That is not sovereignty, and it is not independence.

Conclusion

- The UK enhances Scottish influence, security, public spending and cultural reach. A Yes vote would be unaffordable and would not enhance real independence.

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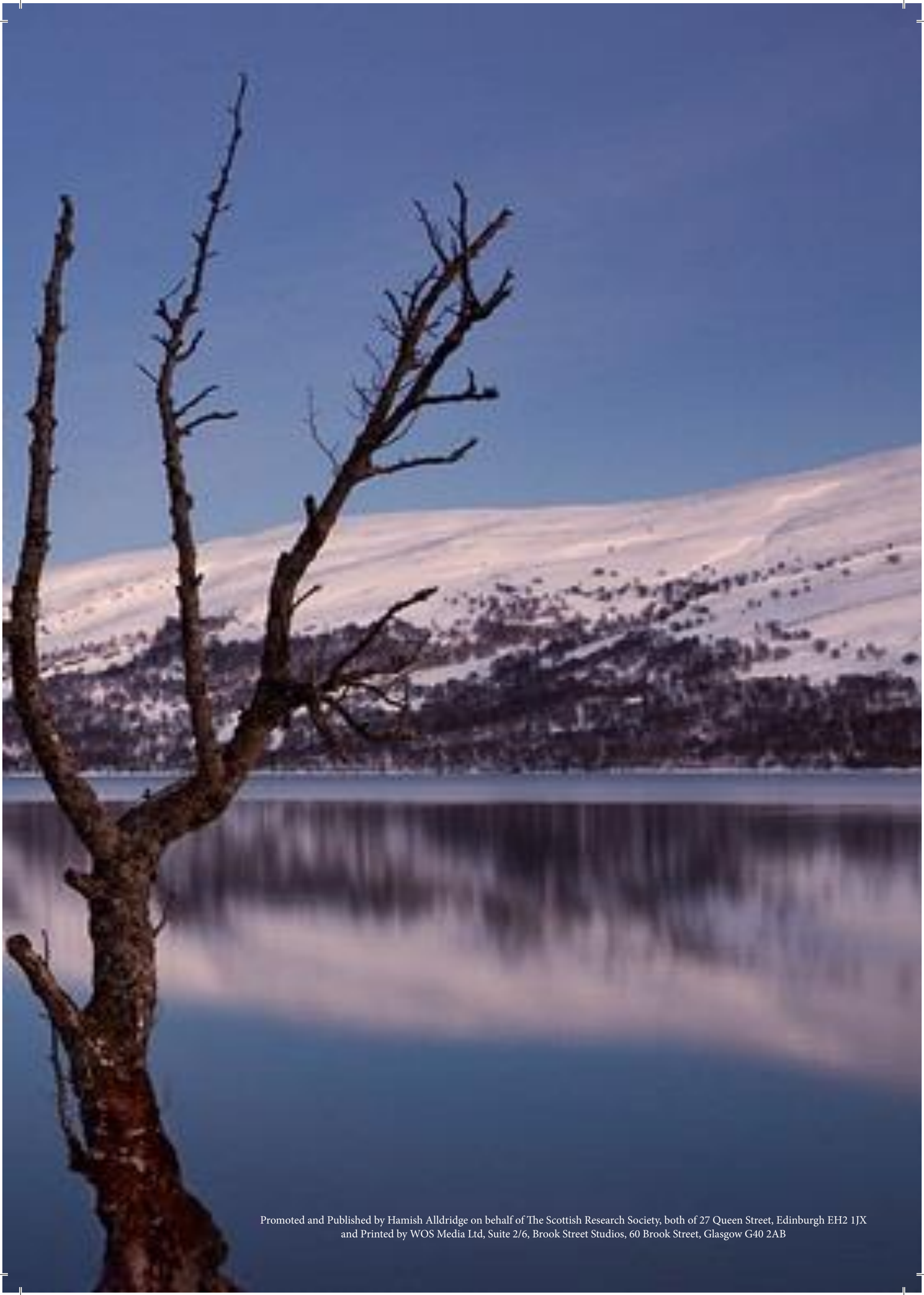

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