

## Why Scotland must keep the pound – and why it can't

### **Can an independent Scotland keep the pound and, if not, what are the alternatives and what do they mean? Answer: a 20% cut in public expenditure**

The SNP's unrealistic and impossible position about the pound and the national debt masks what is really in store.

Scotland cannot be permitted by England/Wales/Northern Ireland to continue to use the pound for one trump-card reason not mentioned by any other commentator: it could not allow a co-user of its currency to have sole sway over the timing and amount of the sales of 24 billion barrels of oil – whose price is quoted in USD - against the pound.

Instead Scotland must issue its own debt in its own currency upon independence, and with its own credit rating, and its fiscal policy must comply with the EU Fiscal Stability Treaty. That means cutting public spending to reduce debt from 71% of GDP upon independence to 60% by 2030.

That could mean a 20% public expenditure cut as compared with today's levels, given the threats to GDP and tax revenues deriving from the non-oil&gas sector, and the uncertainties over the quantity of oil&gas that will be extracted from the North Sea and its world price.

There will be no land flowing with milk and honey after independence. The maximum annual benefit of independence is £1,500 per head, caused by the oil&gas tax revenues flowing directly to Holyrood and not Westminster. But Scottish public spending per head is already £1,200 higher than in the rest of the UK, leaving a best-case benefit of £300 per head - with plenty of reasons to suppose that the net effect will be neutral or negative.

Robert Lyddon, who is an expert in international banking, working through his own consultancy company Lyddon Consulting Services, has written a report that tackles these questions head on and cuts through all of the SNP's propaganda.

Mr Lyddon argues that the SNP must at all costs assure EU Membership, and this will be open to them if:

1. Scotland adheres strictly to the 'continuity of effect' principle, which will at the same time rule out-of-court the SNP's prospectus policies on immigration and higher education
2. Scotland agrees to join the euro
3. Scotland establishes its own currency, as it must in order to establish a convergence path with the euro, and the new currency is immediately made a member of the ERM

This will relieve Scotland of many of the risks and issues connected with a truly independent currency, but at a price:

- Obtaining its own credit rating
- Submitting to third-party verification of its debt-to-GDP ratio now, at independence and thereafter (meaning by rating agencies and by the European authorities)
- Compliance with the Fiscal Stability Treaty
- Accepting a 5/63<sup>rd</sup> share of the UK national debt as the price of being released from its current position: jointly and severally responsible for all of it

If the UK national debt were split on a per capita basis, Scotland would take on GBP102 billion, with a GDP of 144 billion: a 71% debt-to-GDP ratio, fully 11% worse than the Fiscal Stability Treaty target.

GDP and tax revenues would also be falling and public expenditure rising due to factors not mentioned in the SNP Prospectus, leaving aside the SNP's plans for extra spending:

- Repatriation of pensions and investment business to avoid Scottish Country Risk
- Repatriation of public sector workload
- Inability to tax Scottish banks' profits made in other former UK countries
- Social costs caused by GDP reductions
- Higher cost of doing business for Scottish companies
- Running public services on a smaller scale but higher complexity
- Disproportionate usage of Private Finance Initiative
- Cost of separation

These factors drag Scotland's debt-GDP ratio up from 71% into the 80s within three years of independence, and if the SNP were then to implement their 'First Budget' and 'First Term' Prospectus Promises, debt-to-GDP would rise to 90%.

This would not even be possible under the EU Fiscal Stability Treaty, under which Scotland would have to start cutting public expenditure severely as soon as it launched its own currency in the ERM.

Mr Lyddon exposes the argument about usage of the pound and whether or not Scotland will take on any of the national debt as a smokescreen to obscure the real implications of independence: the SNP's airy statements about Scotland's wealth and policy choices are belied by a detailed examination of the figures and applicable legal frameworks.

Mr Lyddon demonstrates that the choice facing the Scottish people is much simpler than the SNP would claim, with its wide-ranging references to all the powers and choices at the disposal of an independent Scotland:

- The straitjacket of the ERM and the euro, and much-reduced public expenditure; or
- Stick with the UK and the pound.

The SNP's declaration, in its prospectus for an independent Scotland, that Scotland will keep the Pound in exchange for Scotland taking on a share of the UK national debt, is a clever but misleading statement from the SNP which is ultimately not backed up with any concrete examples or explanation.

He also argues that the SNP's claim that the UK's Treasury Note backs up the statement made in their prospectus, is fundamentally untrue. He points out that in fact the Note states the complete opposite - that Scotland would have to take over its share of the national debt by issuing its own bonds in a different currency.

Mr Lyddon commented: "It is clear from the SNP's statement that they are trying to hide the truth, which is that Scotland would have to obtain their own independent currency".

His paper goes straight to the heart of the truth about Scottish fiscal independence, and explores the considerations and mechanisms around an independent Scotland, including:

- If Scotland becomes independent, it would have to take over a share of the UK national debt on day one. As the UK government's position currently stands, this would mean Scotland would have to issue its own bonds in a different currency and pay the proceeds to the UK on day one.
- For Scotland to be successful in the sovereign debt market, they would need obtain a Standard and Poors AAA rating, which would not be possible for Scotland to obtain on day one.
- The SNP's idea of having the GBP as Scotland's currency and national debt is aimed at avoiding the above situations, since their credit rating would be the same as the UK, AAA, if they kept the current status quo.
- If the UK were to share the GBP with Scotland, it would significantly devalue the GBP for the UK. In a GBP sharing scenario, the UK would not be the sole user of the GBP, thus exposing the UK to significant Sovereign Risk. This risk would be similar to that of the recent Euro crisis.
- The SNP prospectus fails to make a case that Scotland has an engine for GDP growth apart from oil and gas. They have treated the oil & gas reserves as both proven and at the top end of the available range of estimates. Consequently, their predication of 2% year-on-year GDP growth is completely out of touch with reality.
- The SNP claim that Scotland would be the next Dubai, Abu Dhabi or Qatar after independence. However, the SNP fail to mention that Scottish expenses will rise due to

higher costs of doing business, running public services and the cost of separation. Thus, Scotland would not be able to offer the same tax incentives as Dubai and Abu Dhabi.

- The SNP's claim that a monopoly on oil & gas tax revenues would pay for the extra Scottish public spending per capita now, and then yield an extra £300 per annum per head are completely ridiculous. The increase in extra expenses and loss of GDP as a result of independence would account for the £300 and then would add to Scotland's deficit. Thus, Scotland would take over at least £102 billion of debt on Day Zero of independence and the debt amount would increase rather than fall thereafter.
- Mr Lyddon has calculated that if Scotland were to become independent in early 2016, its national debt would be £102 billion, as pointed out above. He then predicts that Scotland's debt would then rise by £4 billion in 2016 and £2 billion in 2017. These, statistics clearly undermine the SNP's claim that Scotland's debt would decrease rather than increase post-independence.
- Overall, independence for Scotland means no GBP, no big bonus from oil & gas tax revenue, a substantial national debt of at least 71% of GDP, and a number of substantial risks for GDP and tax revenues.
- Mr Lyddon thus believes that the SNP has only two real options:
  - Face much higher servicing costs on the national debt of an independent Scotland in the Scottish Pound Currency, and a higher national debt as well: considerable on Day Zero, and more likely to rise than fall thanks to existing trends and the SNP's spending mission; or
  - Keep debt-service costs capped and then on a downward path by joining the Euro, issuing the national debt in that currency, and abiding by the Fiscal Stability Treaty.