Williamson Memorial Lecture Draft Ten

Sterling and Albion: The financial case for a United Kingdom

Introduction

Good evening.

It is a real privilege to be here to deliver the Andrew John Williamson Memorial Lecture, and I’m delighted that Andrew’s mother Joyce has been able to join us this evening.

When I looked down the list of the other figures who have delivered this lecture over the last thirty years it made rather intimidating reading.

There have been Prime Ministers, Liberal leaders, Home Secretaries, Chancellors...
And I’m sure that they’ve all been given the same piece of advice at some point in their careers.

Which is, that if you’re going to deliver a long speech, or a lecture, you should always start with a joke to relax your audience.

Now as I’m going to be speaking about our country’s future today, I thought I’d Google the words ‘Scotland’ and ‘jokes’.

I don’t know if any of you have ever tried this (?), but the result of such a search is pages and pages of jokes about the fact that Scottish people are perceived as being – I guess the nice way of putting this is – careful with their money.

[A characteristic, incidentally, which I’m pleased to admit to in my current role. With public money at least!]
So there’s the joke about the Scot who shares a taxi with a girl so beautiful he can barely keep his eyes on the meter.

Or the one about the Scottish widow who rings up her local paper to place a notice of her husband’s death.

‘What would you like it to say?’ the man from the paper asks.

‘Robbie Macfarlane. From Parkhead. Dead’ says the lady.

‘You know...’ says the man from the paper, ‘...you could probably squeeze in three or four more words?’


Rightly or wrongly this reputation precedes us.
[And] The internet is littered with these jokes about Scottish people being careful with their money.

And if those jokes are based on any kind of truth.

If indeed we are a nation that makes – shall we say? – rational and considered economic decisions.

Then I hope to demonstrate to you tonight that the only sensible option at the ballot box next year is to vote no to independence.

**Thatcher and identity**

Yesterday, I attended the funeral of Margaret Thatcher.
Whatever your views on her legacy, her death serves as an opportunity to reflect on just how much our country has changed over the last forty years.

She was a hugely significant figure, and each of us will have our own feelings and reflections on her time in office.

Taking the longer view on today’s subject, one of the issues that I – as a teenager, growing up in Lochaber in the 1980s – disagreed with her on was the constitutional position of Scotland.

By refusing what seemed to me then, and still does now, as the logical option and democratic wish of most Scots for Home Rule within the UK, her politics created a feeling in some parts that the choice must be between direct rule from London or separation from the United Kingdom.

[But] With the Constitutional Convention and the creation of the Scottish parliament, Scottish politics moved beyond that false choice to a more modern and democratic future.

This has given Scotland a devolved and cherished Parliament, within a strong and secure United Kingdom.
It has given us the best of both of worlds.

It is striking that the only one significant figure in Scottish politics who continues to try to force us to choose between being Scottish and British is Alex Salmond.

[And] I believe that framing our choice in that way is as wrong now as it was in the 1980s.

I’m a Highlander, a Scot, a Brit and a European.

As a teenager in Lochaber I chose the Liberal political tradition because it is a creed that recognises that those different identities can sit comfortably alongside one another and be reflected democratically within one United Kingdom.

Nationalism is all about building up barriers between people.

Liberalism is about knocking them down.

I’m someone who spent their schooldays in Fort William and their university days in Oxford.
I am a Scottish MP and I serve the whole of the UK as a member of the British Government.

And for all those reasons, I believe strongly that being part of the United Kingdom offers us huge advantages in the 21st century.

And it is that which I want to talk about for the remainder of this lecture.

I’d like to lay out why I believe the current arrangement – that of a strong United Kingdom – is the best economic and financial arrangement for both Scotland and the rest of the UK.

And I’d then like to explore some of the big [economic] and financial talking points around independence; around the future of currency and the future of the financial industries. And around the future of North Sea Oil and Scotland’s long term fiscal sustainability.

And in doing so, I will explain why I believe that Scotland’s future will be more stable and more prosperous as part of the UK.
To be clear, I am emphatically not one of those who says we cannot be independent. That we are too weak or poor to do it.

Far from it.

But I do believe that in making that choice we must have a hard headed understanding of the scale of that choice and the consequences that flow from it.

Security

Firstly, being part of a United Kingdom offers us *greater financial security*.

The people of Scotland are part of – within the United Kingdom – a broad tax base of 30 million individual taxpayers and over 4 million registered businesses.
And having that broad a tax base means that we pool our risks. That we share a collective insurance premium.

Yes, it means that the rest of the UK benefits from the strong performance of certain Scottish industries.

And yes, it means that the wider UK benefits from our natural resources.

But it also means that Scotland – in turn – benefits from the diversity of the UK economy as a whole.

And it means that – were there to be any isolated shock to the Scottish economy – the performance of industries across the rest of the UK could absorb that.
When Alistair Darling – a colleague of mine on the ‘Better Together’ campaign – was Chancellor of the Exchequer, UK taxpayers spent £45bn recapitalising the Royal Bank of Scotland. And the bank also received £275bn of state support in the form of guarantees and funding.

Now that support is equivalent to around two years of Scotland’s total economic output.

A disorderly collapse of the banks in an independent Scotland would have had devastating consequences for depositors, and devastating consequences for growth and for jobs in Scotland.

But through the central UK authorities we were able to deliver an immediate and co-ordinated response to a major bank failure and protect deposit-holders in every part of the UK.

The security that being part of the UK offers is therefore of absolute importance, in a conventional sense but also economically.
Scale

Secondly, being part of the United Kingdom also offers us *scale*: larger markets, more competition, greater choice.

And free movement of workers and of goods and of trade – within a single domestic market – is of enormous help to the whole of the country.

It generates jobs - One in five Scottish employees working for a registered company work for a company owned elsewhere in the UK.

It reduces costs.

It encourages innovation.

And it gives our citizens greater consumer choice.
All of which have contributed to the development of the UK economy for over three hundred years.

**Influence**

Thirdly, being part of a United Kingdom gives Scotland *greater influence*, and access to markets across the globe.

It allows our interests to be represented at a range of international tables. Whether that be the UN Security Council or as one of the largest members within the EU. Or whether it be in NATO, or at the G8 and the G20.

It increases our opportunities to trade internationally.

In fact, Scots were among the first to take advantage of the opportunities the union offered us in terms of global trade.
An independent Scotland would need to create that influence and the networks that support it from scratch, it would need to negotiate the terms of entry to multinational bodies, and it would need to build the resources to promote its own industries and its own exports overseas afresh.

Now I’m quite certain that we Scots have the reach, and the nous and the charm to do all those things.

But I can’t understand why we would choose to build those barriers, knowing that it will take us years to knock them back down again.

Integration

And finally, as part of the United Kingdom we all benefit from integration.
It might sound strange to say this so close to the Wallace Monument, but as part of the UK, Scottish people actually have greater freedom.

And the fact that Scottish people are able to move freely throughout the UK for work, and for education – and that when we do so we are able to carry our qualifications with us, remain in the same tax and benefits regime, and continue to save towards the same pensions – is not only enormously reassuring, it is also enormously helpful for individuals and businesses, and enormously efficient for our economy.

I’ve taken advantage of that freedom. As I’m sure have many of the older members of this audience.

And I hope that many of the younger people here will do so in the future.

Options on independence
So those are the key reasons I think we are better together;


Why won’t we pre-negotiate

Now there is a school of thought that says that in the event of a vote for independence, the UK and an independent Scotland would negotiate away any problems and continue their lives as happy neighbours.

And so it goes that – as a result – Scotland’s potential loss of the UK’s security, scale, influence and integration is all greatly exaggerated.

I have no doubt that both the UK and Scotland would – if it came to it – negotiate Scotland’s independence in a responsible manner.
But what we cannot do – while we are still one United Kingdom – is pre-empt those negotiations and make false promises or wish away all the consequences of independence.

We won’t sign a pre-nup three hundred years into a successful marriage.

And what I will not pretend is that – even if the SNP managed to negotiate effectively – an independent Scotland, and the continuing UK for that matter, wouldn’t be worse-off economically.

The SNP likes to claim in public that there would be a cash benefit to independence.

In private though – thanks to John Swinney’s leaked analysis of Scotland’s public finances – we know that the real prospectus is weaker public finances, potential tax rises and years of difficult fiscal decisions.
There is a lot of uncertainty around Alex Salmond’s proposals for independence. We don’t even – for example – know what currency a future Scotland will be operating in.

And so I’d like to spend the rest of my time with you exploring some of the key questions for Scotland’s financial future.

The future of our currency.

The future of our financial service industries.

The future of North Sea oil and gas.

And an independent Scotland’s fiscal sustainability.

Currency – Four Options
I first set out my thoughts on currency over a year ago, and as many experts – including the Lords Economic Affairs Committee – have agreed, the question of what currency an independent Scotland would use may seem dry and technical, but it is a question of critical importance to Scotland’s future.

And next Tuesday, Government will be launching an in-depth paper on this very issue, which I would encourage you to read in detail.

That paper will explore the four basic currency options that an independent Scotland would face, and it’s worth spending a little time thinking about each tonight.

There would be Alex Salmond’s current preferred answer – that of a formal sterling currency union, which would have to be agreed with the United Kingdom.
There would be the option that Alex Salmond has proposed on at least one occasion, that of continuing to use sterling, without any formal agreement of the UK.

And there would be Alex Salmond’s previous preferred answer – which is for Scotland to join the Euro.

All three of those options – it’s worth saying at this juncture – would mean an independent Scotland giving up sovereignty over monetary policy.

Meaning that the first act of an independent Scotland would be to sign away crucial aspects of its economic independence.

[And] The only way to avoid that loss of sovereignty would be the fourth option – that of introducing a new Scottish currency; a policy that some prominent supporters of independence have recently argued for.
So let’s quickly explore each of those possibilities in turn.

Firstly that an independent Scottish state enters a **formal sterling currency union** with the continuing UK; where Scottish businesses, and households and Universities continue to use sterling, and the Bank of England acts as a common central bank to both countries.

Such an arrangement would see both Scotland and the United Kingdom continue to use the same currency.

And there would be no short term costs in terms of printing new coinage, or setting up new financial institutions...

But such a union would be likely to present problems in both the long and the short term.

It is extremely challenging to combine monetary union with full fiscal independence.
And the lessons learned from the Eurozone have been clear for all to see.

That while such arrangements can appear successful in a period of stability, they can lead to brutal readjustments in times of economic stress and uncertainty.

[Now] There are ways around those risks.

Explicit “no bail out” clauses.

Centrally-imposed rules to promote fiscal discipline, and sanctions where they are breached.

But design is one thing, and execution is another.
[And] Fiscal rules are complex to design and difficult to enforce among independent countries.

One must also question what ‘independence’ really means if fiscal policy had to be so tightly constrained.

This commitment would be tested by financial markets, particularly if there were any expectations of the currency union being a transitional or temporary arrangement, as has been suggested by a number of prominent nationalists recently.

Maintaining a stable currency union within a divided UK could be very challenging.

Maybe not impossible, but extremely challenging.

It would require a very carefully designed framework. Some very clear conditions. And it would have to be negotiated between an independent Scottish state and the continuing UK.
And it is not clear how this framework would work, or if it would work at all.

Of course, it is quite possible that an independent Scotland could simply continue to use the pound without any formal agreement with the UK government.

The pound is – after all – an international trading currency.

And there are examples elsewhere in the world of such arrangements working.

Ecuador and Panama use the dollar.

Montenegro uses the Euro.
But such an arrangement would mean that the Scottish government had to borrow in a currency over which they had no control, and that they possessed very limited levers to support financial stability.

The Scottish Government’s own Fiscal Commission, advise that such an arrangement is “not likely to be a long-term solution” for a country of the size and the complexity of Scotland.

And I’m sure that any Scottish historian among us would be very wary of a Scotland that – once again – looks towards Panama for its financial future!

In fact, I’m sure the Scottish public at large would be wary of such a financial arrangement.

Another difficult sell to the Scottish public – the third of the currency options– would be for an independent Scotland to adopt the Euro.
In fact, there is a possibility that – were an independent Scotland to apply for EU membership – they would be given no other option but to commit to enter the single currency, as that has been a condition for new members of the EU since 1992.

So what would Scottish entry to the Euro area mean?

Euro area monetary policy is set for the euro area as a whole, and Scotland’s size – about that of Greece or Portugal – would mean that its economic conditions would have limited effect on overall policy. A much more limited effect than it has as part of the UK.

And while the euro area is reforming in response to recent events – ‘while Europe’s eye is fix’d on mighty things’ if you will – it would simply not be the right time for Scotland to enter that particular economic and monetary union.
Which leaves an independent Scotland with a fourth and final monetary option; that of introducing an independent Scottish currency.

While I said previously that discussions on this issue can seem quite dry and clinical, it is also true that some people can have a real emotional investment in currency.

I remember much of the early UK debate around the Euro coming from a position of taking pride in our coins and our notes.

And I’m sure – as such – that an independent Scottish currency would prove popular amongst supporters of independence; as it has started to among some of the members of the Yes campaign.

And as I mentioned earlier – and as a number of commentators have highlighted – this would be the only option under which an independent Scottish State would be fully sovereign over its monetary and fiscal policy.
But any such policy would – again – present real issues.

Primarily, a number of new institutions, including a central bank, would need to be established, at a cost to the Scottish taxpayer;

And in the longer term, the choice of Scotland’s exchange rate regime would have massive implications for the future of the currency.

[Now] None of the four options I’ve described are entirely unworkable.

I’m sure that strong arguments could be made in favour of each.

But all of those options would come with short term costs, and all of those options would come with long term uncertainty.
Neither of which the Scottish public is calling out for.

The other thing we have to bear in mind is that any one of those four options would involve replacing a system that works. And continuing with the status quo is simply not an option for an independent Scotland.

The simplest way to guarantee keeping the pound is for Scotland to stay in the UK.

The current arrangements of a full monetary, fiscal and political union with substantial devolution deliver longstanding benefits for Scotland and the UK; but – as the experience of the euro area has shown – a single currency without full fiscal and political union is a very different thing.
The choice of currency for an independent Scotland would be a complex issue, and keeping the pound in a formal sterling currency union would have to be agreed with the continuing UK.

As I’ve said, the UK Government will be publishing an in depth analysis on this issue next week, which I urge you all to read.

[PAUSE]

Financial Services

Our financial services sector is of great importance to our nation’s finances.

In 2010, financial and insurance activities contributed £8.8 billion to the Scottish economy; accounting for more than 8% of Scottish onshore activity. And the sector directly employs over 80 000 people in Scotland; around 3% of total Scottish employment.
Were that sector to remain in an independent Scotland, it would no doubt continue to offer a large number of jobs to our people.

But such a large sector in such a [comparatively] small country would put Scotland in a position of some vulnerability.

Before the crisis broke in last month, Cyprus had banking sector assets of around 800% of GDP.

This was a major contributor to the cause and impact of the financial crisis, and on the ability of the Cypriot authorities to prevent the systemic effects when it hit.

If Scotland became independent, banking sector assets would be even larger, at over 1200% of GDP.

[Now] The United Kingdom can absorb and support such a large industry – it hasn’t been easy, but we showed we could weather the storm.
It would however, be very difficult for an independent Scotland to do the same;

With a sector the size of Scotland’s, a systemic banking crisis could call the sovereignty of the whole country into question, with devastating consequences for businesses and individuals.

We’ve seen just how dangerous it was for the last UK Labour Government to allow the financial sector to run out of control.

And we’ve seen how long it’s taking for the country to recover from the banking crisis.

The idea then, that an independent Scotland would be even more exposed to the financial sector should give the people of Scotland serious pause for thought.
We want to retain a strong, successful and large financial sector, and remaining in the UK is the best way to do so.

Scottish independence would also have a huge impact on our domestic financial markets.

Scottish Financial Enterprise, the representative body for Scotland’s financial services industry, reports that 90% of its members’ customers are across the border in the rest of the UK; and

Similarly, UK firms are important to people living in Scotland. For example, an estimated 70% of all pension products bought by Scottish consumers in the financial year 2011-12 were bought from firms based in the rest of the UK.

So – were Scotland to become independent – it would place an international border in the middle of these transactions; another
example of Alex Salmond preparing to build a barrier where no barrier needs to be.

North Sea oil and gas

Despite the importance of the financial sector though, the main talking point around future Scottish industry seems to concern the future of North Sea oil and gas.

The Nationalists would have you believe that with a geographic share of oil, the activity and revenues from the “black gold” in the North Sea will ensure an independent Scotland’s prosperity;

And it is on this basis that the Scottish Government likes to claim that taxpayers in an independent Scotland will be better-off financially.

Not only is this line of argument incredibly simplistic, it is also misleading.
Let’s be absolutely clear how dependent these calculations are on North Sea oil revenues.

And let’s be categorical that these figures are based on a Scottish economy that benefits from being integrated and insulated within the larger UK economy.

The Government Expenditure and Revenue Scotland – or GERS – figures, as published in March do not reveal the fiscal position of an independent Scottish economy, as the Scottish Government would have you believe.

They suggest that with a geographic share of the North Sea, Scotland – as part of the UK – has contributed broadly the same proportion of the UK’s revenues since devolution as it has received in public spending.

This geographic share averages almost £6bn a year since devolution.
But crucially, the geographic share of North Sea oil and gas revenues has fluctuated from just over £2bn to almost £12bn depending on which year you look at.

Of course these receipts are very important to the United Kingdom.

North Sea revenues represent around 1-2% of total tax receipts.

But the UK as a whole – once more – can absorb the level of volatility in these returns by pooling tax revenues from the broad and diverse tax base I discussed previously.

For the figures produced for Scotland though, this geographic share of the North Sea would represent around 10-20% of their revenues;

Which is a huge dependence on a volatile and unpredictable source of revenue.
Far more important to the independence question is not what has happened to Scotland as part of the UK since devolution though, but what the challenges are that Scotland will face in the future.

The way in which the revenues, and liabilities, of the North Sea would be split in the event of a vote for independence would clearly be a matter for negotiation.

But, whatever the split, the independent Office of Budget Responsibility has forecast that oil revenues will be on a downward trajectory over the medium and long term.

What this means is that by 2016-17 – which is the Scottish Government’s preferred year to begin independence – it is forecast that revenues will be around half the average of recent years.

While this can be managed by the broader and more diverse UK-wide economy, a halving of North Sea revenues would equate to a significant reduction in Scotland’s total revenues – somewhere in the region of £4bn.
For essential public services to be dependent on a volatile, unpredictable and falling resource of oil is putting at risk those very services that we rely on for our health, our education and our livelihood.

[And] This fiscal gap is equivalent to a third of Scotland’s health budget or half of Scotland’s education spending. For income tax to fill this gap, receipts would need to increase by more than a third.

Alongside this decline in receipts, we are also due to see acute demographic challenges in Scotland – with the proportion of the population over 65 expected to rise from just under 27 people for each 100 of working age today, to almost 52 per 100 of working age in 2060.

In other words, by 2060, Scotland is expected to have fewer than two people of working age for every person over 65.

[And] This decline in working age people.
This decline in the tax base.

And this decline in North Sea oil receipts would present an independent Scotland with real financial challenges.

We face these same long term fiscal challenges within the UK – nearly all of the developed world faces these problems.

But as the independent Institute for Fiscal Studies has said: “over the longer run... an independent Scotland would face a bigger fiscal adjustment than the rest of the UK”;

If there ever were an independent Scotland, it would be under fiscal pressures from Day One.

Under fiscal pressures at the exact time that it would be required to enter financial markets and prove its fiscal credibility for the first time.
And under fiscal pressures at the same time as the Scottish Government is promising to cut taxes and raise spending.

This is a false prospectus that does not add up.

We are stronger, and we will be more prosperous together than we would be apart.

Pre Conclusion

[So] On those talking points I am very clear in my beliefs.

I believe that our currency is stronger as part of a United Kingdom.

I believe our financial sector is stronger as part of a United Kingdom.
I believe our energy sector is stronger as part of a United Kingdom.

And I believe that our fiscal position is stronger, more sustainable, and less volatile as part of a United Kingdom.

Conclusion

I’m very grateful to you for taking the time to come here and listen this evening.

And I’m especially pleased that Joyce has been able to travel here to listen this evening.

Because it is crucial that – over the next eighteen months – the people of Scotland are given access to a lively, healthy and informed debate about the future of our country.
This evening I’ve only managed to cover some of the more financial questions around independence – but there are so many other areas it will affect.

Our defence system.

Our welfare system.

Our businesses and infrastructure.

Our immigration and borders system.

And I hope that the national debate manages to cover each of these before people take to the ballot boxes next September.

I know which road I want to see our country taking.
We are better together;

And I will be spending the next year garnering as much support for that cause as I can.

[I’ll also – I believe – be spending the next twenty minutes taking that debate forward with you]

Thank you for listening.