Scottish independence:

a political and economic appraisal

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About the author

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Executive summary

Scots will vote on independence on 18 September 2014. The vote will be close, with the margin likely to be less than 15%. While no serious commentators doubt that Scotland can become a independent state, in this paper we contend that the Scottish National Party's (SNP) proposals published in November 2013 as the "Scotland's Future" white paper do not stand serious examination in the key areas of currency, fiscal and monetary policy, and EU membership.[1]

If Scots vote for independence, Scotland is likely to have a new currency pegged to sterling, a proportionate share of the UK's debt, higher borrowing costs and weak public finances. The most likely scenario sees an independent Scotland outside the EU at independence, with EU accession and ratification taking 24 – 36 months from independence. EU membership is unlikely to be on the preferential terms that the UK currently enjoys.

In the interregnum, Scotland is likely to have an European Economic Area (EEA)-style agreement to provide access to the European single market; like Norway, Scotland should expect to pay for market access. Tariff-free access to the EU market is critical: with 65% of Scottish exports going to the rest of the UK, and additional exports to the rest of the EU, an extended period outside a free-trade zone would be disastrous for Scottish manufacturing and financial and professional service exports.

An independent Scotland would be nearing its 15th birthday in 2030. By 2030, oil production on the UK continental shelf is projected to be one third of 2010 volumes,[2] declining at 4.8% per annum.[3] After 2030, the depletion of these hydrocarbon reserves makes the economic premises of the current SNP independence proposals untenable. As a result, 2030 would provide a sensible point to assess the impact of independence.

The likely 2030 outcome of independence is an ageing Scotland that is poorer than the UK counter-factual.[4] However, if the (currently unfinanced) social transfer increases proposed in "Scotland's Future" are enacted, 2030 Scotland would likely have lower economic disparities than today. The first 15 years of Scottish independence are therefore likely to prove fiscally challenging, with the economic risks on the downside; a Norwegian-style oil fund is unaffordable without significant fiscal tightening. Medium term Scottish prosperity will be determined by Scotland's ability to increase non-oil competitiveness, reducing its reliance on declining hydrocarbon revenues.

For the SNP's core supporters, these economic arguments and legal uncertainties are largely irrelevant: the core purpose of independence is to allow Scotland to make its own choices. But for undecided Scots, economic and legal uncertainties are likely to weigh heavily. Reflecting the policy weakness of the SNP's case, CentreForum expects a narrow vote against independence.

A vote against independence should not be interpreted as a vote in favour of the union in its current form. In a political gamble, the Westminster parties opted for an in/out question, rather than increased fiscal autonomy known as "Calman Plus" or "Devo-Max" favoured by a majority of Scots. It is likely that a vote against independence will be followed by further devolution to Scotland, triggering a broader constitutional realignment across the UK. The likely 2030 outcome of a No vote is a more federal UK.

Quebec's first independence referendum was held in 1980; the subsequent three decades have been dubbed a "neverendum", during which Quebec's future within Canada has never been guaranteed.[5] A narrow vote against independence will surely tempt a future SNP Scottish government to break its "not again for a generation" pledge.[6]

Note

This paper will use the term United Kingdom (UK) to mean the current nation-state comprising England, Northern Ireland, Scotland and Wales, and the rest of the UK (rUK) for the rest of the UK minus Scotland post independence.

On 18 September 2014, Scotland's four million voters will decide whether to remain in the UK or to become the world's newest country in March 2016.[7]

Scotland's economy

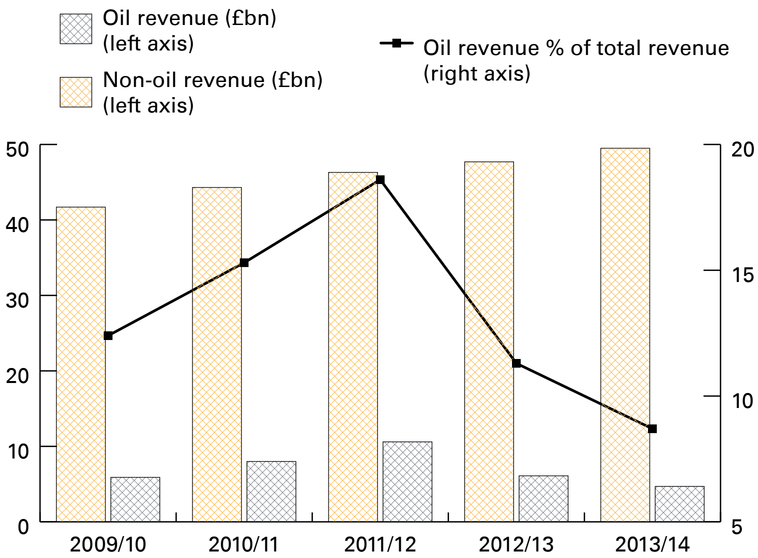
Scotland's economy mirrors that of the rest of the UK. Scotland's 2012 nominal GDP was approximately £152bn[8] or 9.2% of UK GDP, slightly ahead of its 8.3% population share. Reflecting this, 2011 Scottish average Gross Value Added (GVA) of £20,571 was 98.5% of the UK average, and above all regions except London (171% of the UK average) and the South East of England (107% of the UK average),[9] though this masks significant internal variation within Scotland.[10]

Scotland's economy is highly integrated with the rUK, with an average of 65% of Scottish exports going to the rUK between 2008 and 2012,[11] and Scotland sourced 71% of 2008/09 imports from rUK.[12] Though an important market for the rUK, Scotland is relatively small, providing a market for 10% of the rest of the rUK's exports, versus 20% to North America and 40% to the rest of the EU. Consequently, Scotland is substantially more reliant on the rUK market than the rUK is on the Scottish market. This reliance on the rUK market underscores the importance for Scotland having tariff-free access to the rUK and the EU at independence.

Oil and gas

Hydrocarbons provided 7.2% of Scottish GDP and 18.6% of notional Scottish government revenue in 2011/12.[13] With revenues determined by a combination of production volumes, world oil price, production costs, the excise regime and investment tax credits, actual revenues have shown significant volatility over the last decade seen in Chart 1, with oil tax revenues falling from £10.6bn in 2011/12 to £6.1bn in 2012/13 and £4.7bn in 2013/14.[14]

Chart 1: Scottish government revenues 2009/10 – 2013/14



Geography means that Scotland would enjoy between a 79% and 84% share[15] of UK continental shelf (UKCS) hydrocarbon revenues. UKCS reserves are predominately in mature fields where production is declining, meaning that maintaining revenue at existing levels will be increasingly dependent on high-cost new fields and improved technologies to achieve higher recovery rates. Tax take peaked in 1984/85 at £28bn, and fell to £6.1bn in 2012-13.[16] The Office for Budget Responsibility (OBR) noted in March 2014 that oil production fell 8.8% in 2013; the OBR is forecasting a further 3.6% fall in 2014 before stabilising to 2019.[17]

As the University of Glasgow's Centre for Public Policy for Regions (CCPR) showed in March 2014, oil revenues are the difference between a 2012-13 Scottish deficit in line with the rUK at 8.3% (UK 7.3%)[18] or at 14.0%, nearly twice that of the UK.[19] This leads the CPPR to conclude that "it would need currently unforeseen improvements in North Sea production and/or the oil price before Scotland's fiscal balance reverted to being better than the UK's."[20] Hence, declining oil production presents downside risks to Scotland's short and medium term fiscal position.

It remains to be seen how the Scottish Government could fund a Scottish Energy Fund on the Norwegian model.[21] Having ruled out tax rises[22], without substantially higher oil revenues, the Scottish budget will have limited fiscal headroom, meaning that an oil fund will have to directly compete with other areas of government spending or increased borrowing. In the short term, Gavin McCrone considers the oil fund unaffordable[23], noting that a oil fund would mean "even more draconian steps would be required to eliminate the budget deficit" and that for this to change would require "quite a transformation in the Scottish economy, either by reducing the need for such a high level of public expenditure or somehow increasing other tax receipts."[24] The oil fund is our first example of where Scotland's Future creates unfunded fiscal pressures on the Scottish budget. We will see this as a recurring theme.

Financial services

Currently, financial services produces 13.1% of Scottish regional GVA[25], provides 6.1% of Scotland's employment[26], and 15.8% of Scottish exports.[27] However, this prominence comes at the cost of scale: HM Treasury estimated that the Scottish-based financial sector in May 2013 had assets equivalent to 1254% of GDP[28] – nearly three times the UK's already high 492%, and larger than pre-crisis Ireland (894%)[29], Iceland (880%)[30], Cyprus (700%).[31]

The outsized financial sector means that a future financial crisis is likely to overwhelm a Scottish government's ability to bail it out. The RBS bailout comprised a capital injection of £45bn plus £275bn in government guarantees, equivalent to 211% of Scottish GDP.[32] Though all financial sector risks are not alike – Scotland's fund managers and insurers are less risky than the investment banks – such an overstretched Lender of Last Resort (LOLR) is neither credible nor sustainable. This led Standard and Poors (S&P) to conclude that the lack of such a credible LOLR would adversely affect the credit rating of Scottish domiciled financial institutions, leaving them at a competitive disadvantage if they retain their Scottish domicile.[33]

LOLR is a classic low probability / high cost risk that markets and governments have historically proved poor at assessing and costing. In this case, the rUK is unlikely to want to take on 91% of the LOLR risk of the Scottish financial sector. The absence of a credible domestic LOLR for the Scottish financial sector's systemic players means that these organisations will need to seek LOLR protection outside Scotland. The probable result is that systemic financial services firms are likely to move their domicile from Scotland, irrespective of Scottish government policies. Whilst the largest firms moving their domicile would reduce Scotland's LOLR risk, to the extent that domicile determines employment and tax jurisdiction, such a move would also adversely impact Scotland's revenue base.[34]

: Scotland's currency

An independent Scotland's currency arrangement is central to its economic future. Reflecting the views of the Scottish government's Fiscal Commission Working Group[35], the SNP's preferred currency solution is a full currency union with the rUK, which the SNP claims is in the interests of both countries.[36]

No to a currency union

This was collectively dismissed by George Osborne, Danny Alexander and Ed Balls in February 2014, with Osborne taking the unusual step of publishing the policy advice from the Treasury's Permanent Secretary advising against a currency union.[37] Alex Salmond and his deputy Nicola Sturgeon have retorted that this position is "bluff and bluster".[38] Will a currency union happen?

It is very unlikely. The reasoning in the Treasury paper is clear, and builds on the modelling of the euro "Five Tests" in 2003.[39] Successful currency unions need to:

- Connect highly integrated, convergent economies
- Be designed to be permanent;
- Have a high degree of political, as well as fiscal and monetary, policy integration.

The proposed currency union currently meets the first criteria – as the Treasury notes, the existing UK is one of the most successful monetary unions in history.[40] However, the SNP's case for independence is underpinned by the notion that Scotland needs distinct economic policies to the rUK[41], meaning that beyond the distinctive features of the two economies (eg the much greater proportionate role hydrocarbon revenues play in Scotland) the economies will diverge over time, placing real stress on a currency-but-not-political-or-fiscal-union.

The SNP are a recent convert to a sterling zone currency union; in 1999, Alex Salmond memorably described sterling as a "millstone around Scotland's neck".[42] "Scotland's Future" argues that the sterling zone should not be seen as a permanent agreement.[43] In seeing a sterling currency union as a temporary expedient, it undermines the notion of permanence, inviting speculation over when – and on what terms – Scotland would leave it. Thus, the second criteria is not met.

Finally, it is hard to envisage distinctive Scottish economic policies that are simultaneously highly integrated with rUK fiscal and monetary policies and financial sector oversight from London. The political implications of rUK vetoing a Scottish budget or tax rates would presumably be extremely negative; similar Scottish oversight of rUK budgets is equally unlikely.[44] HM Treasury concludes that "there is no evidence that adequate proposals or policy changes to enable the formation of a durable currency union could be devised, agreed and implemented by both governments".[45] CentreForum agrees. As a result, the third criterion fails.

Why does the SNP want a currency union?

This critique of a currency union is entirely predictable, leading to two questions. First, why did the SNP propose it? Second, why have they persisted in pressing for a currency union after the Westminster parties rejected it?

The SNP appear to have proposed the currency union for two reasons. First, a currency union derisks independence for the Scottish electorate by retaining sterling and the financial backstop of the rest of the UK. Alex Salmond's gradualist SNP leadership made a strategic choice to base their case for independence on retaining as many familiar elements of the UK as possible, bolstered by significant additional social spending supposedly denied to Scotland by the existing devolution settlement.[46] Derisking independence has resulted in the SNP's recent enthusiasm for sterling, NATO membership[47] and the monarchy[48], all overturning long-held SNP positions.

Second, a currency union is attractive because it allows Scotland to retain the Bank of England as LOLR to Scotland's financial sector, minimising the risk of the sector moving their staff and tax domicile to the rUK. In doing so, the SNP is asking the rUK to subsidise an international competitor to one of the rUK key export sectors, a proposition that was never likely to prove attractive.

Continuing to support a currency union after the unionist parties comprehensively rejected it provides two benefits to the SNP. First, it continues a narrative of unionist / Westminster condescension and "bullying" of Scottish voters, and that the position of the Westminster parties is "bluffing" and/or "bluster".[49] There is no convincing evidence to support this contention. The principal benefit for the rUK of a currency union over a peg is a notional 8.3% Scottish contribution to rUK bank bailouts in return for the significantly greater risks of underwriting the proportionately much larger Scottish financial sector.

The second benefit for the SNP of continuing to insist that Westminster will "concede" a currency union is that it obviates the need to lay out the costs and benefits of the most likely alternative: an independent currency pegged to sterling.

Plan B – Currency peg

Operated by a currency board, a peg provides stability at the cost of importing monetary policy from the external state when accompanied by an open capital account.[50] Optimally, a currency would be pegged to a basket of currencies weighted to its trading partners. Though it has not been explicitly stated by the SNP, SNP rhetoric suggests a single peg against sterling.[51] Given that 65% of Scottish exports are currently to the rUK, pegging exclusively to sterling is a slightly sub-optimal peg design, but is unlikely to be too problematic in the short-term. However, as the rationale is political – notably to protect pensioners[52] and mortgage holders from exchange rate risk – in the event of an external shock to either Scotland or the rUK, this political rather than economic basis makes modifying the peg more difficult.

As well as importing the rUK's monetary policy, a currency peg would limit Scottish fiscal policy, especially in the early years of independence. Whilst the UK's currency reserves would be divided on a per-capita basis between the rUK and an independent Scotland, initial Scottish reserves are unlikely to be large enough to provide market confidence in the peg. Increasing the reserves in the short term represents another area of the white paper's unfunded expenditure.

Alex Salmond has repeatedly asserted that the rUK's refusal of a currency union would impose transaction costs of £500m on rUK exporters to Scotland.[53] Ignoring the contested nature of the £500m figure, a pegged currency would minimise (and in practice, eliminate) this cost. Thus, as a peg provides the rUK with almost all of the benefits of a currency union with none of the attendant risks, a currency union is a practical political impossibility.

UK national debt

HM Treasury confirmed in January 2014 that the UK would continue to honour all UK debt issued up to putative Scottish independence in 2016.[54] This announcement made clear that in the event of Scottish independence, UK debt would not be divided to create two classes of bonds with distinct risk profiles. In doing so, it minimised the UK's risk premium and borrowing costs prior to September's referendum.

Alex Salmond and other SNP spokespeople have chosen to interpret this to mean that a proportionate share of UK debt could be refused without a currency union.[55] Scotland's population share of the gross UK national debt in 2016 is estimated to be £143bn[56], thus a Scottish refusal to bear it share implies an increase in the rUK national debt of nearly £2,400 per head.[57] On Citibank's analysis, this would increase in the rUK's Maastricht Debt/GDP ratio from 89% to close to 98%.[58] Given the impact on rUK government finances, is the SNP position on the debt likely to hold if a currency union continues to be rejected?

A proportionate share of UK debt is in Scotland's interest

CentreForum's assessment is that an independent Scotland is very unlikely to refuse to service a population proportionate share of the UK debt based solely on Scotland's national interest. There are two reasons for this.

First, though Scottish refusal to bear a proportionate share of the UK national debt would not be a formal default, it would represent an unwillingness to pay. Citibank notes that, "any demonstrable 'unwillingness to pay' would, presumably, have a negative impact on its rating as this is one of the major causes of sovereign defaults".[59] The National Institute for Economic and Social Research (NIESR) estimates that ten year Scottish sovereign debt would trade at a 72 – 165 basis point premium over rUK gilts assuming that Scotland paid its share of the existing UK debt.[60] If Scotland were to refuse a proportionate share of the debt, Citibank notes this risk premium would be "significantly wider"[61], making all borrowing in Scotland considerably more expensive.

Avoiding any market perception of a sovereign default will be critical to an independent Scotland as it establishes its own credit record. In 2016/17, Scotland will have a funding requirement to cover more than 5% Scottish fiscal deficit[62], in additional to a maturing debt share estimated by NIESR at £23bn in 2016/17.[63] It is therefore imperative for Scotland to be seen as a responsible issuer from independence, meaning that it cannot afford to be stigmatised with "unwillingness to pay".

Second, realpolitik. Scotland will be heavily reliant on rUK goodwill, especially in EU accession negotiations over which the rUK has a veto. Given the importance to Scotland of EU membership, alienating the rUK represents a poor strategic choice. Few policy choices are more likely to alienate the rUK electorate than handing them a bill of £2,400 per head at independence.

Taken together, CentreForum is confident that taking a proportionate share of the UK's debt is in Scotland's national interest.

Scotland and the euro

The SNP's vision of an independent Scotland's future in the eurozone[64] has been replaced with a sterling denominated future.[65] However, no new applicant since the Maastricht Treaty has avoided a formal obligation to join the eurozone; Sweden's anomalous position[66] meeting the criteria but making no attempt to join the euro is likely to be the best that Scotland could expect to achieve.[67] However, as Sweden demonstrates, there is no apparent reason why this position could not be maintained indefinitely.

Nonetheless, Scotland isn't Sweden, and may find that the euro is a more secure home than an informal sterling peg or an independent currency. If so, future Scottish fiscal projections need to reflect the Maastricht convergence criteria, themselves considered a fair yardstick for responsible fiscal management. NIESR have modelled a ten-year fiscal consolidation for Scotland to meet the Maastricht criteria, finding that including a geographic split of oil revenues, a 2% growth rate and a per capita split of the UK's debt, Scotland's primary fiscal surplus would have to be 3.1% per annum, implying a permanent and immediate fiscal tightening of at least 5.4%.[68] As NIESR observes, this implies more austerity for longer in an independent Scotland than is proposed for the UK through to 2020.[69]

State secession and succession

International law provides the framework for what happens when new states are formed by secession from existing states. As outlined by Professors James Crawford SC and Alan Boyle in their opinion "Referendum on the Independence of Scotland: International Law Aspects", the most likely position is that the rUK would be considered the continuation of the UK, and that Scotland would be a new state.[70]

Thus, the rUK would retain the UK's name, and continue to hold its existing international memberships, treaty rights and obligations and sovereign debts. In common with other new states like South Sudan, an independent Scotland would not be a member of any international bodies, though Crawford and Boyle believe the European Convention on Human Rights would probably continue to apply.[71] Post-independence, Scotland would be free to choose which organisations and treaties to apply to join.

Independence-by-secession presents a new legal problem for the EU. Never before has a state been created by secession from an existing member sought EU membership.[72] When Greenland, a Danish overseas territory, elected to leave the EEC in 1985 it was explicitly attempting to leave the EEC but not to become independent. Scotland's case offers the reverse, with Scotland seeking independence from the UK whilst seeking EU membership.

Though contested[73], it is most likely that Scotland would be outside the EU at independence, and would need to apply for membership.[74] [75] As the rUK would remain in the EU, Scottish citizens who had not renounced their UK citizenship would remain EU nationals, maintaining their rights to live and work across the EU.

EU membership

Article 49 of the EU's current constitutional text, the Lisbon Treaty[76] invites European non-member states to apply for EU membership. The working assumption is that applicants are expected to fully implement the EU's rulebook, known as the acquis communautaire. Any opt-outs need to be approved by all 28 existing EU member states.

Successful EU membership applications require unanimity in the European Council, meaning that existing EU members have a veto over membership applications.[77] Given that an independent Scotland already meets the requirements for membership as part of the UK, accession negotiations and ratifications should be relatively swift, taking perhaps 24 – 36 months.[78] How long the negotiation and accession process would take would depend on what opt-outs Scotland sought to secure, and on agreeing outstanding issues with the rUK.

It may be possible for Scotland to gain market access through the European Economic Area (EEA), though this would incur a cost. Norway is currently paying €188m per annum between 2014 and 2019, and adjusted for relative wealth and population, Scotland's contribution should be approximately €75m per annum.[79] Outside of the EU, Scotland would be ineligible for Common Agricultural Policy (CAP) subsidies and EU structural funds. Given the role that they play in the Scottish economy, it would be reasonable to expect Scotland to mirror these subsidies nationally. Replacing CAP subsidies would cost £577.3m in 2016/17.[80]

Which route? Article 48 versus Article 49

Rather than the normal Article 49 application, the SNP proposes to seek EU membership under Article 48.[81] The SNP's rationale for this is an assertion that membership can be achieved by March 2016, allowing Scotland to seamlessly enter the EU on independence.

Unfortunately, Article 48 is designed for Treaty changes rather than membership applications, and in his evidence to the European and External Relations Committee of the Scottish Parliament in January 2014, Professor Kenneth Armstrong, Head of Cambridge's Centre for European Legal Studies concluded that Article 48 "cannot plausibly be used" [82] for Scotland's membership application.

Instead, as the European Commission has made consistently clear since 2004, the route for states outside the EU to apply is through Article 49. This position was reiterated by European Commission Vice-President Viviane Reding as recently as 20 March 2014.[83]

Beyond legal arguments, a series of practical political arguments militate against the SNP's proposed approach.

- First, other EU member states with secessionist movements – notably Spain (Basque Country and Catalonia), Belgium (Flanders) and France (Basque Country) – have no incentive to approve an automatic and seamless EU membership post-secession, fearful that this would make secession more likely.
- Second, reducing the number of opt-outs from the acquis (the so-called "Europe a la carte" problem) is a priority when admitting new members. Given that the UK enjoys a range of opt-outs ranging from the euro to the Working Time Directive, allowing Scotland to enter the EU on the same basis the UK currently enjoys is unlikely.[84] Significant changes to the Common Fisheries Policy or maintaining Scotland's £260m population share of the UK's rebate are extremely unlikely.[85]
- Whether losing the UK's labour market regulation opt-outs constitutes a material competitive disadvantage for Scottish business vis-à-vis the rUK remains unclear. However, it highlights that the loss of the UK's opt-outs presents a downside risk to Scottish productivity and labour market flexibility.

- Third, a full Treaty revision process initiated under Article 48 would be impossible to limit to Scottish independence, as every other EU member state would have the right to add items to the proposed Treaty revisions. Even if an Article 48 route were possible, it risks dragging out the process of Treaty revision to such an extent that the supposed time advantage would likely be negated.

It is very unlikely that an independent Scotland would be able to achieve the seamless automatic transition to EU membership outlined in the SNP's White Paper via Article 48. It should be assumed that Scotland would spend at least 24 months outside the EU after independence whilst a Scottish application under Article 49 is processed and ratified.

Implications of a Yes vote

Implications for Scotland

The polls have been tightening in 2014, with the anti-independence vote now maintaining a 5 – 10% lead down from an up to 20% lead in January 2014; an independence vote is certainly possible in September.[86] In this event, negotiations will start on the practicalities of disentangling the structures that have grown up to support the 300-year political union. Heavily technocratic, it is to be hoped that cooperative working relationships between UK and Scottish civil servants would provide as smooth a transition as possible.

Coming to an agreement

However, current disagreements between Westminster and Holyrood that are domestic disputes amenable to political horse-trading will become international disagreements between two governments responsible to their electors for maximising their respective national interests. This is a very different dynamic, and is likely to lead to considerably more turbulence in the relationship. The increasing shrillness of the campaign is unhelpful, as it is likely to entrench positions on both sides.

A comprehensive agreement between rUK and Scotland is a precondition for EU entry: if not, the rUK could slow or stop Scotland's application.[87] Some areas present significant obstacles to agreement. First, currency and national debt considered above. Second, apportionment of assets, including the North Sea maritime boundary.[88] Third, defence issues, specifically Alex Salmond's "cast-iron" guarantee to remove Trident missiles, submarines and warheads from Scotland.[89] However, Scotland's imbalanced reliance on the rUK and EU markets weakens Scotland's negotiating position.

Scotland's fiscal position

Scotland's fiscal position after independence is already tighter than the UK because of higher spending per head and the current level of North Sea revenues. SNP projected polices, including building up reserves to support a currency peg, funding the Scottish Energy Fund, dealing with higher interest rates on Scottish debt, whilst meeting the NATO 2% military spending target[90], fulfilling the increased social spending and not raising taxes, exacerbate this position. As CPPR note, "It would need currently unforeseen improvements in North Sea production and/or the oil price before Scotland's fiscal balance reverted to being better than the UK's."[91]

Scotland is very unlikely to become insolvent, but the economic and demographic risks are on the down side. It is for this reason that Citibank expect independent Scotland to have a "relatively weak and risky fiscal position"[92], and the medium term economic outlook is heavily dependent on volatile hydrocarbon revenues – the more so if the lack of a credible LOLR sees significant migration of the financial services sector from Scotland.

Scotland in 2030

The likely 2030 outcome of independence is a Scotland that is poorer compared with the unionist counter factual. However, if social transfers increase as proposed in "Scotland's Future", 2030 Scotland would likely have lower economic disparities than today. The end of oil production in the 2030s remains the key challenge to an independent Scotland's long-term economic vitality.

Implications for the rUK

Scottish independence would remove 59 MPs, 8.4% of the population, approximately 30% of the land area, 50% of the coastline and between 79 – 84% of oil revenue from the rUK. A central plank of the nationalist case is that Scotland has no impact on governance at Westminster; others assert that minus Scotland the smaller but marginally richer rUK[93] would have a natural Conservative majority.

Neither proposition is wholly accurate. In the 18 postwar elections, Scotland has elected more Labour MPs than Conservatives when a Conservative government was returned to Westminster in 1959[94], 1970[95], 1979[96], 1983[97], 1987[98], and 1992[99]. Conversely, in 1964[100] and in both 1974 elections[101] Scottish MPs returned a Labour government in what would otherwise have been a Conservative victory; in 2010[102] Scottish MPs denied the Conservatives a majority. CentreForum's analysis of current YouGov polling projections suggest that a general election held today without Scotland's 59 MPs would deliver Ed Miliband a 15 seat Labour majority.[103]

So though Scottish independence does not guarantee an rUK Conservative government, it makes achieving a Conservative majority after 2015 easier. In doing so, it increases the (currently low) probability of an EU in / out referendum occurring in 2017, indirectly marginally increasing the likelihood of an rUK exit from the EU.

The broader economic picture for the rUK is largely neutral. If Scotland took on none of its £143bn debt share, Citibank projects that rUK Maastricht Debt / GDP ratio would rise to 98%, and the rUK deficit would increase by 0.2 – 0.3% to cover the increased debt service.[104] Beyond this, the rUK would suffer slightly worse terms of trade with the loss of North Sea oil, but to the extent that Scottish financial and professional service sectors relocated to the rUK for regulatory certainty and LOLR protection, Scottish independence could be an economic positive. In economic terms, the rUK's relationship with the EU is of much greater importance than Scottish independence.

The psychosocial impact on England of the "loss" of Scotland is harder to predict. It is likely to be viewed by most with equanimity, though it would also remove the irritation of the perceived unfairness of Scotland's public spending settlement; the fact that differential public spending levels are largely illusory does not mask the perceived unfairness of state-funded prescriptions, pensioner social care and university tuition. However, a refusal by Scotland to bear a proportionate share of the UK debt is likely to provoke calls for political retaliation, with a hold on Scotland's EU membership pending agreement on the UK's debt the most likely countermeasure.

Wales

Scottish independence would present a different challenge to Wales; the Welsh nationalists of Plaid Cymru have made clear that they view Scottish independence as a major step towards their vision of an independent Wales. The impact of Scottish independence on non-aligned Welsh opinion is likely to be coloured by how successful an independent Scotland is, and how relationships within the rUK itself develop. Whilst England represents 84% of the UK population, it would be 92% of the rUK, and without the social and economic balance provided by Edinburgh, the rUK runs the risk of being more London-centric than the UK today. As a result, the rUK itself is likely to have to become more decentralised to meet Welsh and Northern Irish concerns.

Implications of a No vote

The SNP insist that the referendum would not be repeated for a generation, to allay fears of Quebec style instability and "neverendum". However, a narrow defeat for independence would likely lead to calls for a subsequent vote in the next decade.

In a campaign that has been marked by negative campaigning on both sides, a narrow No victory is likely to be a vote against the SNP's version of independence rather than an endorsement of the status quo. To their credit, the Westminster parties recognise this. Labour[105] and the Liberal Democrats[106] have tabled proposals for further Scottish devolution; the Conservatives are expected to do so in June.

Despite the lack of agreement on which additional powers should be devolved, the direction of travel is clear: after a No vote, there will be more devolution, including to Wales, leading to a more-or-less federal UK. Additionally, a federalising structure also provides a framework for Scottish reintegration to the UK if a Scottish Government committed to rejoining the UK were subsequently elected. CentreForum and the Constitution Society outlined a range of federal options in our 2013 paper "If Scotland says 'No': What next for the Union".[107]

In the short-term, a No vote is likely to result in a classic British constitutional fudge. Though a fully-fledged English Parliament is unlikely, increased devolution to Edinburgh, Cardiff and Belfast means that the Tam Dalyell MPs' famous 1977 West Lothian question needs answering.[108] Unfortunately, the recent McKay Commission proposals[109] would fail to stop a government forcing through England-only proposals opposed by the majority of English MPs. In a world of further devolution, this is unlikely to be enough, probably leading to "English votes on English laws" at Westminster.

This is a deceptively radical step. Combined with an elected upper house, it would effectively create different classes of Parliamentarians based on geography. Those ministries whose remit was devolved outside of England – e.g. health – are likely to be limited to having ministers from English constituencies; it would clearly be nonsensical to have a Health Secretary who could not vote on their Department's legislation. This would limit the career choices of non-English MPs, but however odd this appears, it is the reality of current NHS policy in Scotland and Wales, where it has resulted in substantially different delivery models. More importantly, it would also reflect what people have voted for.

By 2030, the UK would likely have evolved into a federal state, with England probably acquiring a parliament of its own. Under federalism, the UK Parliament would likely retain competence over national fiscal policy and federal transfer payments, foreign affairs and defence, EU relations, UK internal market, environment and national infrastructure, with the remainder of policy devolved.

Conclusions

Successful modern economies are built on credible economic policy and currency arrangements, a well-regulated financial sector and facilitated through free trade via the WTO and/or an appropriate regional free trade organisation. As proposed by the SNP, an independent Scotland would start with major questions over all of these elements.

An independent Scotland is likely to begin life outside the EU for a period, paying for access to the rUK and wider EU markets, with an economy dependent on volatile oil for at least 10% of government revenues and a currency pegged to sterling with no control of monetary policy and limited control over fiscal policy. It will do this against a backdrop of coping with a larger fiscal deficit than the rUK that is likely to cost 72 – 165 basis points more than rUK gilts to finance under new, unproved institutions. If Scotland were to refuse to finance the £143bn proportionate share of the UK's debt this servicing cost would rise substantially.

The SNP's expensive social spending proposals, funding an oil fund and increased reserves to defend the currency peg, the likely relocation of significant elements of the banking and professional services sector in lieu of a credible Scottish LOLR, and the medium-term fiscal consolidation to move towards the Maastricht criteria are all expensive. Despite this, the SNP asserts that it can achieve all three without raising taxes – a position that is very hard to reconcile.

This is likely to translate into a very bumpy economic ride after independence, which the SNP have studiously avoiding sharing with Scottish voters. The challenge over the medium term is to diversify the economy away from hydrocarbons before 2030, and deal with faster ageing, lower-skilled population than the

UK as a whole. Scotland could overcome these challenges, but it is likely to be poorer but less economically disparate than an increasingly federal UK counterfactual. It is for Scottish voters to weigh these contrasting futures in September, but on a policy basis, CentreForum expects a narrow No vote.

Notes

1 Scotland's Future, Scottish Government, November 2013.

2 These figures relate to the UKCS as a whole, rather than Scotland's putative geographic share of UKCS production as the data is aggregated at the national level. Department of Energy and Climate Change Production Projections, March 2014, Table 1, p. 4.

3 CentreForum analysis of 2026 – 2030 production projections from Production Projections, March 2014, Table 1, p. 4.

4 See Fiscal sustainability of an independent Scotland, Institute of Fiscal Studies, November 2013, p. 9

5 On Quebec's "Neverendum" see, e.g., The 'neverendum referendum', Anne McIlroy, The Guardian, 15 July 2002.

6 Scotland's Future, p. 3.

7 See News Release: Increase in Scottish Electorate, General Register Office, Scottish Government, 2012.

8 Scotland Analysis: Financial Services and Banking, Cm 8630, HM Treasury, May 2013, p. 22.

9 http://www.ons.gov.uk/ons/rel/regional-accounts/regional-gross-value-added--income-approach-/december-2012/sum-interactive-maps.html

10 SMID via http://www.theguardian.com/news/datablog/interactive/2012/dec/18/deprivation-scotland-map

11 CentreForum analysis of Scotland's Global Connections, Scottish Government, January 2014, Table 3, p. 6, Table 6, p. 9.

12 CentreForum analysis of 2008/09 SNAP data from Scottish Government at www.scotland.gov.uk/Resource/Doc/933/0108920.ppt.

13 CentreForum analysis of Scottish Government figures. 2011–12 saw total Scottish Government revenues of £56.9bn with oil contributing £10.6bn, or 18.6%.

14 HMRC figures cited by Chief Secretary to the Treasury Danny Alexander in an Edinburgh speech, 30 April 2014.

15 HM Revenue and Customs estimates Scotland's share of UK oil revenues at 79%, whereas Professors Kemp and Stevens at Aberdeen University estimates the Scottish geographic share at 84%. See Analysis of Scotland's Past and Future Fiscal Position, John McLaren and Jo Armstrong, Centre for Public Policy for Regions, March 2014, p. 6.

16 In 2009-10 pounds, using HM Treasury deflators. See Scottish Independence: Weighing Up the Economics, 2nd Edition, Gavin McCrone, Birlinn, Edinburgh, 2014, p. 134. Professor McCrone was Chief Economic Adviser to the Scottish Office in 1974, and wrote a briefing for incoming ministers entitled The Economics of Nationalism Re-Examined that suggested that the discovery of North Sea oil would fundamentally change the economic case for Scottish independence. This paper has been a touchstone for Scottish Nationalists since it was leaked in the 1970s.

17 Economic and Fiscal Outlook March 2014, Office of Budget Responsibility, March 2014, p. 95; Production Projections, March 2014, p. 2.

18 Analysis of Scotland's Past and Future Fiscal Position, Table 3 p. 9.

19 Analysis of Scotland's Past and Future Fiscal Position, Table 1 p. 4.

20 Analysis of Scotland's Past and Future Fiscal Position, p. 1.

21 Scotland's Future, p. 382.

22 Scotland's Future, p. 118.

23 See, e.g. "Gavin McCrone: Is an oil fund still feasible?", The Scotsman, 18 October 2013.

24 Scottish Independence, p. 17.

25 Regional contribution of UK Financial Services and Professional Sector 2013, TheCityUK, p. 6.

26 Regional contribution of UK Financial Services and Professional Sector 2013, p. 6.

27 CentreForum analysis of Scotland's Global Connections, Table 7, p. 11.

28 Scotland Analysis: Financial Services and Banking, p. 25.

29 Scotland Analysis: Financial Services and Banking, p. 26.

30 Scotland Analysis: Financial Services and Banking, p. 25.

31 Scotland Analysis: Financial Services and Banking, p. 25.

32 Scotland Analysis: Financial Services and Banking, p. 22.

33 "S&P doubts independent Scotland's ability to support banks", Chris Giles, Financial Times, 23 April 2014.

34 RBS, Lloyds Banking Group and Alliance Trust are reported to be establishing legal entities in England to allow for moving operations out of Scotland. Scottish independence: What have businesses been saying?, BBC News, 31 March 2014.

35 The Fiscal Commission Working Group comprises Andrew Hughes Hallett, Sir Jim Mirrlees, Frances Ruane and Joseph Stiglitz, and is chaired by Crawford Beveridge. See http://www.scotland.gov.uk/Topics/Economy/Council-Economic-Advisers/FCWG.

36 Scotland's Future, p. 399.

37 HM Treasury's assessment is Scotland Analysis: Assessment of a Currency Union, Cm 8815, February 2014, see; for the letter from HM Treasury Permanent Secretary Sir Nicholas Macpherson to the Chancellor of the Exchequer Scotland and a Currency Union, 11 February 2014.

38 "Alex Salmond blasts Westminster's Currency Union 'bluff'", Financial Times, 30 March 2014.

39 Scotland Analysis: Assessment of a Currency Union, p. 6.

40 Scotland Analysis: Assessment of a Currency Union, p. 5.

41 See e.g. Scotland's Future, p. x, p. 5.

42 Alex Salmond speaking to the Centre for European Policy Studies in Brussels in November 1999. For a contemporaneous account see The Herald, 10 November 1999.

43 The White Paper describes the lack of permanence for the currency union thus: "it would be open to people in Scotland to choose a different [currency] arrangement in the future." Scotland's Future, p. 111.

44 Scotland Analysis: Assessment of a Currency Union, p. 47.

45 Scotland Analysis: Assessment of a Currency Union, p. 49.

46 It is noteworthy that no Scottish Government has used the 1997 income tax varying powers by up to 3% to provide increased resources for the Scottish Parliament. After refusing to pay HMRC to maintain the technological platform to allow Scottish income tax rates to be varied, the power was effectively lost. New tax varying powers in the 2012 Scotland Act are yet to come into effect.

47 The SNP overturned a 30-year policy of opposing NATO membership at their 2012 conference. See 'SNP members vote to ditch the party's anti-Nato policy', BBC News, 19 October 2012.

48 First the monarchy, then the currency … now another SNP policy shift, David Torrance, The Scotsman, 16 April 2012.

49 See e.g., "UK parties 'ganging up' to bully Scots into rejecting independence, says SNP", Nicholas Watt, The Guardian, 12 February 2014.

50 The free movement of capital is one of the EU's founding four freedoms, and is a pre-requisite for Scottish membership of the EU or the EEA.

51 Inferred from assertions that pensions will continue to be paid in pounds despite the rejection of a currency union. See e.g. Scotland's Future, p. 435.

52 Scotland's Future, p. 24, p. 27.

53 First Minister's Speech, Scottish Government, 17 February 2014.

54 "Treasury gives debt pledge on Scotland", George Parker, Robin Wigglesworth, Mure Dickie, Financial Times, 12 January 2014.

55 "Alex Salmond responds angrily to Osborne's rejection of currency union", Severin Carrell, The Guardian, 13 February 2014.

56 NIESR analysis of OBR and Bank of England data in Assets and Liabilities and Scottish Independence, NIESR Discussion Paper 426, Angus Armstrong and Monique Ebell, 7 April 2014, Table 3, p. 9.

57 CentreForum analysis of HM Treasury 2014 Budget data.

58 "UK — Scottish Independence: Will It Happen? What Would Be The Implications?" Citi Research, Citibank, 7 March 2014, p. 9.

59 UK — Scottish Independence: Will It Happen? What Would Be The Implications?, p. 11.

60 Scotland's Currency Options, NIESR Discussion Paper 415, Angus Armstrong and Monique Ebell, 8 October 2013, p. 4.

61 UK — Scottish Independence: Will It Happen? What Would Be The Implications?, p. 13.

62 Figures from speech by Chief Secretary to the Treasury, Edinburgh, 30 April 2014.

63 Assets and Liabilities and Scottish Independence, p. 11.

64 The SNP leadership was defeated at the SNP's 2009 conference when it attempted to drop euro membership from the party platform. See "SNP European divisions laid bare", BBC News 16 October 2009.

65 Scotland's Future, p. 13.

66 Sweden has consistently met the Maastricht convergence criteria for HICP inflation, Budget deficit to GDP, Debt to GDP and long-term interest rates. Sweden needs to meet the criteria of two years' membership of the Exchange Rate Mechanism (ERM-II) with a variance of +/- 2.25% around the peg. Sweden maintains that ERM-II membership is optional, and Sweden's political parties have made ERM-II membership subject to a national referendum. Consequently, Sweden will remain outside the eurozone for the foreseeable future.

67 The Maastricht Treaty was signed by the then 12 EEC member states in February 1992, with Denmark and the UK having a formal opt-out from the euro. All subsequent accession countries are formally required to join the euro, and currently Austria, Cyprus, Estonia, Finland, Latvia, Slovakia and Slovenia have joined the euro. Of the 1994 accession states, only Sweden remains outside of the euro.

68 Assets and Liabilities and Scottish Independence, p. 14.

69 Assets and Liabilities and Scottish Independence, p. 14.

70 Scotland Analysis: Devolution and the implications of Scottish Independence, Cm 8554, 12 February 2013, p. 68. There has been no case since 1945 in which a seceding entity – even in the case of Bangladesh, which was larger than West Pakistan – became the continuator state.

71 Devolution and the implications of Scottish Independence, p. 68.

72 At the time of independence in 1962, Mediterranean Algeria had formally been a part of metropolitan France rather than a colony since 1848. To date this is the only case of secession from an EU member, but it is little of precedental value given that despite the French constitutional position, Algeria was to all intents and purposes a colony, and saw its independence in terms of the anti-colonial struggle and had no interest in remaining within the then EEC.

73 E.g. by Sir David Edward the British Judge of the European Court of Justice from 1992 to 2004. However, In Sir David's published opinion Scotland is not guaranteed automatic entry to the EU, merely that there is an obligation to enter into good-faith negotiations over Scotland's future EU membership. In any event, such an amendment would have to occur under Article 48 of the Lisbon Treaty and would be subject to national vetoes from existing EU members.

74 Devolution and the implications of Scottish Independence, paragraph 153, p. 100.

75 Scottish Membership of the European Union: Written Evidence to the European and External Relations Committee, Professor Kenneth Armstrong, Centre for European Legal Studies, Cambridge University, January 2014, p. 9.

76 Article 49 of the Lisbon Treaty, available from www.lisbon-treaty.org/wcm/the-lisbon-treaty/treaty-on-european-union-and-comments/title-6-final-provisions/136-article-49.html .

77 Article 49 of the Lisbon Treaty.

78 CentreForum assessment, based on 6 – 12 months to formally open and close the 35 ratification

chapters, and 18 – 24 months for the 28 Member States to ratify them. The process is outlined at http://ec.europa.eu/enlargement/policy/steps-towards-joining/index_en.htm. The most recent ratification (Croatia) took 25 months from June 2011 to July 2013; Austrian / Finnish / Swedish ratification took six months. Though it is possible that shadow negotiations between Scotland and the EU could take place before independence, but even if this agreed all of the elements of Scotland's application, the formal negotiation and ratification process could not start until after a formal application took place after independence. See Scottish Membership of the European Union, p. 10.

79 CentreForum analysis. World Bank figures of Norwegian GDP / head in 2012 was USD 99,636, and the UK was USD 38,920. Applying the Scottish GVA figures to the UK implies a Scottish GDP / head of USD 38,336, which scaled against the Norwegian contribution of €187.8m and population of 5.109m to Scotland's population of 5.295m provides a scaled Scottish annual contribution of €74.9m.

80 CentreForum analysis of Scottish Government CAP figures available from http://www.scotland.gov.uk/Topics/farmingrural/Agriculture/CAP/CAPEurope10112012/budget-facts31102012 . The £557.3m comprises £478.4m (€580m) in Pillar One subsidies, and £79m (€95.6m) in Pillar Two.

81 Article 48 of the Lisbon Treaty is available from www.lisbon-treaty.org/wcm/the-lisbon-treaty/treaty-on-european-union-and-comments/title-6-final-provisions/135-article-48.html.

82 Scottish Membership of the European Union, p. 2.

83 Vice-President of the European Commission Viviane Reding to Christina McKelvie, Convenor of the European and External Relations Committee of the Scottish Parliament, 20 March 2014.

84 See, e.g., John Kerr, (Lord Kerr of Kinlochard), former UK Permanent Representative to the EU, Don't count on it: Scotland if independent could not assume that rejoining the EU would be easy – or cheap, Prospect Magazine, 23 January 2013.

85 The UK rebate is currently worth £3.11bn per Scotland Analysis: EU and international issues, HM Government, May 2013, paragraph 3.4, p. 58; a population proportionate share of 8.4% is therefore worth £260.4m. McCrone is more definitive: "any notion that Scotland might be able to maintain a share of the UK must be dismissed", Scottish Independence: Weighing Up the Economics, p. 81.

86 For a comprehensive listing of the independence polling since 2012, see UK Polling Report: http://ukpollingreport.co.uk/scottish-independence-referendum.

87 There is a national veto under either the Article 48 or Article 49 procedure. Slowing the process is simple; as each of the 35 accession chapters are adopted under unanimity, each member state can place a hold on an application. This is currently the situation with Turkey's application, as a countermeasure to Turkey's failure to implement the Ankara Association Agreement to Cyprus. See http://ec.europa.eu/enlargement/countries/detailed-country-information/turkey/index_en.htm.

88 On which, for example, see Craig Murray Scotland / England Maritime Boundaries, 11 January 2012.

89 Alex Salmond speaking to the SNP 2014 Spring Conference, Aberdeen. See "SNP Leader Alex Salmond Says No Campaign Is 'Most Miserable, Depressing, Boring' In Modern History" Huffington Post, 12 April 2014.

90 The point here is that it offers no savings over the current UK defence budget which is just under 2.0%.

91 Analysis of Scotland's Past and Future Fiscal Position, p. 1.

92 UK — Scottish Independence: Will It Happen? What Would Be The Implications?, p. 8.

93 As Scotland's GVA is 98.5% of the UK average, removing Scotland from the UK will marginally increase UK GVA / head.

94 In 1959 Scotland returned 38 Labour MPs, 32 Conservatives and a single Liberal. However, Scottish Conservative candidates polled 15,032 more votes than Labour, so it is open to argument whether in Macmillan Scotland got the government that it had voted for.

95 In 1970, Scotland returned 44 Labour MPs, 23 Conservatives, 3 Liberals and a single SNP MP; Heath commanded a Conservative / Unionist Commons majority of 31.

96 In 1979, Scotland returned 44 Labour MPs, 22 Conservatives, 3 Liberals and 2 SNP MPs; Thatcher commanded a Conservative Commons majority of 44.

97 In 1983, Scotland returned 41 Labour MPs, 21 Conservatives, 8 Liberal/SDP Alliance MPs and 2 SNP MPs; Thatcher commanded a Conservative Commons majority of 144.

98 In 1987, Scotland returned 50 Labour MPs, 10 Conservatives, 9 Liberal/SDP Alliance MPs and 3 SNP MPs; Thatcher commanded a Conservative Commons majority of 102.

99 In 1992, Scotland returned 49 Labour MPs, 11 Conservatives, 9 Liberal Democrat MPs and 3 SNP MPs; Thatcher commanded a Conservative Commons majority of 20.

100 1964: Scottish MPs provided a Wilson with a Labour majority of 4 rather than Douglas-Home with a Conservative majority of 1.

101 In 1974's first election Scottish MPs ensured Wilson a Labour minority rather than Heath a Conservative minority administration. In 1974's second election, Scottish MPs provided Wilson with a Labour majority of 3 rather than being a minority administration.

102 In 2010, Scottish MPs held the Conservatives to being the single largest party, resulting in the current coalition. Without the Scottish MPs, Cameron would have commanded a Conservative majority of 19.

103 See UK Polling Report Uniform Swing Projection, http://ukpollingreport.co.uk/ukpr-projection-2, 14 April 2014. A UK-wide General Election held today is projected to elect 347 Labour MPs, 256 Conservative MPs, 21 Liberal Democrats, 8 Other, and 18 Northern Irish MPs. In a UK Commons of 650 members, this is a notional Labour majority of 44. Assuming that the 2015 election returns the five Sinn Fein MPs in the current Parliament and that they continue their abstentionist policy, Labour's majority rises to 54.

Of Scotland's 59 current MPs, there are 41 Labour, 11 Liberal Democrats, 6 Scottish National Party and 1 Conservative. Current polling applied to Scotland shows the Liberal Democrats losing six of their 11 Scottish MPs; if these six seats fell to the second-placed party in 2010, three each would go to Labour and the Conservatives. This projects an adjusted 2015 Scottish Westminster representation of Labour 44 (+3), SNP 6 (NC), Liberal Democrats 5 (-6), Conservative 4 (+3).

Removing these 59 Scottish seats produces a projected 2015 legislature of Labour 303, Conservative 252, Liberal Democrats 16, Others 20, a Labour majority of 15 rising to an effective 25 when Sinn Fein abstentions are included.

104 UK — Scottish Independence: Will It Happen? What Would Be The Implications?", p. 9.

105 http://s.bsd.net/scotlab/default/page/file/26e0eb4bdf4c775d14_ram6b81bk.pdf

106 Campbell II Home Rule Report is available from https://www.dropbox.com/s/.../Campbell%20II%20report.pdf

107 'If Scotland says 'No': What next for the Union?', edited by James Hallwood, The Constitution Society, September 2013.

108 The West Lothian question asked why non-English MPs should be allowed to vote on English-only legislation. Long regarded as a constitutional curiosity, the scale of powers already transferred to Edinburgh – including health, education, environment, agriculture and transport – means that the West Lothian question is increasingly relevant.

109 The McKay Commission's work was published in March 2013 as the Report of the Commission on the Consequences of Devolution for the House of Commons: Executive Summary.