INDEPENDENCE

CURRENCY OPTIONS FOR SCOTLAND

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MORE BREXIT UNCERTAINTY

FOREWORD

As if Brexit wasn't complicated enough, we now have the Scottish government - controlled by the Scottish National Party - requesting a second independence referendum.

All of this raises new questions about the future of the United Kingdom - and what an independent Scotland would look like.

The goal of this eBook is to summarise the possible currency options if Scottish independence becomes a reality.

Patrick Latchford
CEO, Blackwell Global Investments (UK) Limited

LOOKING AT RECENT HISTORY

COVERING OLD GROUND

The question of Scottish independence was supposedly settled back in 2014, when the Scottish people opted to stay within the United Kingdom - which is also made up of England, Wales and Northern Ireland.

The 'No' verdict to independence won the day with 55.3% of the vote. At that point in time, the question of independence was seemingly settled for a generation.

However, developments in domestic UK politics have changed this scenario dramatically.

Firstly, we've seen the Scottish National Party (SNP) become the third biggest party in the House of Commons. In the UK General Election of 2015, they increased their number of MP seats from six to 56 - effectively wiping out Labour's presence in Scotland. From a Westminster perspective, they now completely dominate Scottish constituencies.

The SNP also control the devolved parliament of Scotland. Scottish First Minister, Nicola Sturgeon, is the leader of the party. She has been consistent with the party's 2015 manifesto pledge that another independence referendum request would be made if the UK left the European Union.

In 2015, Brexit was seen as an unlikely outcome by the then Prime Minister David Cameron. But now it's a reality.

Fast-forward to 2017 and we've seen Nicola Sturgeon opportunely place a request for a second referendum for 2018-19. Her argument is that the UK is now a very different country to the one that existed in 2014 - and that 62% of Scottish voters backed remaining in the European Union in 2016's referendum vote.

Currently, the UK government has denied the request for a second independence referendum, citing the importance of the impending Brexit negotiations. They say an independence referendum in 2018-19 would be a distraction and weaken the bargaining position of the United Kingdom.

But make no mistake - Scottish independence is back on the political agenda. So are the questions around what an independent Scotland would look like, especially when it comes to monetary policy and currency.

AN OFFICIAL CURRENCY UNION

IT'S ALL ABOUT INFLATON

The first currency option for an independent Scotland would be to agree on an official currency union with the United Kingdom. Such an agreement would entitle Scotland to keep using the pound sterling as it does today.

This arrangement is beneficial for businesses in both an independent Scotland and post-independence UK, as trading could still be carried out on an even-footing and with no disruption.

However, reaching such an arrangement could prove complex when it comes to monetary policy. The UK would want to secure the right to control monetary policy (through the Bank of England) for its remaining nation states (England, Wales and Northern Ireland), without needing to compromise with the demands of an independent Scotland.

Setting effective monetary policy for a unified country is often tricky enough. How would the Bank of England cope with managing the monetary priorities of two independent countries, which may well experience different fortunes in the future? The answer is with difficulty.

We just need to look at the European Central Bank and the difficulty it has had in setting monetary policy that benefits all members of the eurozone. For example, while Germany has experienced relatively strong economic growth, countries such as Greece have struggled with chronic unemployment. It's this kind of dynamic which the European Central Bank has found difficult to manage with monetary policy.


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SCOTLAND VOTED FOR REMAIN

The pitch for Scottish independence in a second referendum will be made on the back of remaining in the European Union. Scotland did vote for Brexit, so once independent, could it retain membership and adopt the euro?

It's a possible solution, but again there are complexities. Firstly, according to the European Commission, an independent Scotland would have to apply for EU membership. Such a process can take years. For example, Turkey started their negotiations to join the European Union in 2005 and it is still yet to be completed.

However, Scotland is in a different position to Turkey. It already complies with EU law, making some believe that applying for EU membership could be much quicker than other recent examples.

If Scotland joined the euro, it would also be giving up its ability to control its own monetary policy. This has had significant consequences for some smaller eurozone countries. The reality is that an independent Scotland would most likely benefit from being able to set its own monetary policy as its economy adapts to life outside of the UK.

There also remains some serious questions about the future of the eurozone as a whole. Nationalist sentiment is growing across continental Europe, making some EU advocates believe that Brexit could be the first of many decisions to the leave the institution and eurozone.

AN UNOFFICIAL CURRENCY UNION

A VIABLE OPTION?

A third route is available to an independent Scotland. They could choose to keep using the pound sterling, even if no official currency union is agreed with the UK.

Let's be honest, there's an argument to say that the pound sterling also belongs to Scotland. There are also examples around the world of countries using the US dollar and the euro 'unofficially'.

But the downside to such an arrangement centres around monetary policy. By using the pound sterling in an unofficial currency union, an independent Scotland would effectively be surrendering its ability to control monetary policy levers to the Bank of England. These levels include the ability to set interest rates and start quantitative easing programmes.

It's important to highlight here that the Bank of England currently has a duty to tailor its monetary policy to the benefit of the United

Kingdom - which includes Scotland. An independent Scotland that opts to use the pound sterling without an agreement in place with the UK government would no longer be a priority to the central bank.


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