Independence Uncovered:

The Economic and Social Impacts of Scottish Independence

26 February 2023

Scottish Business UK
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About Scottish Business UK

Founded by Robert D. Kilgour in 2017, with former Conservative MEP Struan Stevenson as CEO, Scottish Business UK (SBUK) is an independent, non-party voice for business leaders who want to see Scotland thrive economically as part of the United Kingdom.

As an organisation representing business leaders across a wide range of sectors and geographical areas in Scotland, SBUK has been a vocal and effective opponent of Scottish Government plans to hold a second referendum and stands ready to make the positive case for the UK in future national campaigns.

SBUK has a strong and diverse Advisory Council currently numbering some 60 high profile leaders from business, politics and journalism, who together employ more than 12,000 people in Scotland and over 35,000 UK wide.

Acknowledgements

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Foreword

Observers of the Scottish independence debate have for too long lacked clarity over the true impact of the likely costs to changes in trade, currency, fiscal policy and investment that leaving the UK would entail.

In nearly a decade since Scotland voted 'No' to their 2014 referendum prospectus, Scottish ministers have had ample opportunity to address this shortfall and set out why they believe voters' concerns may have been misplaced. They have continued to push relentlessly for a second referendum without spelling out many of the practical consequences that this decision would entail for our economy. This has become a source of anxiety and frustration, particularly in the business community as it grapples with pandemic recovery and rising costs.

That's why this new research, 'Independence Uncovered', which lifts the lid on the true impact of breaking up the UK, is both useful and timely. Harnessing data sources and economic modelling methods used by the Scottish Government itself and readily recognised by all sides in the constitutional debate, it reveals that leaving the UK would result in an unprecedented 10% cut in the size of the Scottish economy.

Moreover, some 253,000 Scottish jobs would be lost, many in vital public services, often located in deprived areas of the country. At the same time, key business sectors like financial services and retail would be reduced substantially, devastating Scotland's economic competitiveness for years to come.

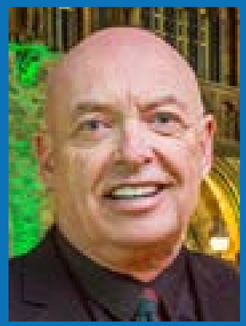
There will be those who will read the report's findings and accuse its authors of 'scaremongering'. That couldn't be further from the truth. Indeed, the sobering fact is that the research deliberately provides conservative assessments of the cost of independence from the factors assessed. What is presented reflects the minimum impacts that Scotland would face if taken out of the UK. The reality could realistically be far worse.

SBUK's aim in publishing 'Independence Uncovered' is to provide accessible facts based on authoritative evidence that can move the present debate forward by helping people assess the tough choices that campaigners for independence want them to make.

Our view remains that by keeping Scotland in the UK we can avoid the economic and social damage predicted in this report, and also give ourselves the best opportunity to grow Scotland's economy as part of the family of UK nations.

Struan Stevenson
Chief Executive

Robert D. Kilgour
Founder and Chairman



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About the author

Richard Marsh has worked as an economist based in Scotland for over twenty-five years. He previously worked at the Fraser of Allander Institute (University of Strathclyde) and international real estate company DTZ. Richard has led high profile economics research projects for the Office of the First Minister for Wales, the Office of the First Minister and Deputy First Minister for Northern Ireland, the Office of the Chief Economic Advisor for Scotland and the European Commission.

Richard undertook research on behalf of the First Minister's Sustainable Growth Commission and is a member of two Scottish Government expert groups advising on statistics and modelling. He completed a three-year secondment at the Scottish Parliament's Financial Scrutiny Unit, supporting the scrutiny of economics and statistics during the independence referendum and the devolution of new powers to Scotland. He regularly undertakes public policy evaluation and appraisal and has supported development projects in Europe and the Middle East including masterplans and inward investment projects.

Introduction

About this report

For many years now, debate has raged about the economic implications of Scottish independence. The 2014 referendum focused on issues such as the currency an independent Scotland would use, its initial financial position and new trading arrangements.

These questions have been frequently reassessed. The Government Expenditure & Revenue Scotland (GERS) report provides an annual update on Scotland's fiscal position relative to the UK as a whole, triggering an almost ritualistic exchange between those on different sides of the constitutional debate.

Trade, energy, defence, welfare, pensions, EU membership, the financial sector, monetary policy and the currency are also regular topics for discussion. Good quality data is collected, and thorough analysis is undertaken in many of these areas. However, at no stage have the issues been aggregated to produce an overall analysis of the likely economic and social impacts of independence.

This study helps to fill that gap. It uses modelling techniques and data widely accepted by economists in Scotland and elsewhere. This ensures that the approaches and data used are as uncontroversial and as informative as possible. Commentators on both sides of the debate have accepted the validity of the main components of this analysis, though no doubt some may contest its overall conclusions.

This report considers the three major factors in the economics of Scottish independence in turn, with a fourth section covering a variety of other considerations:

- Currency arrangements in an independent Scotland;
- The fiscal position;
- Trade;
- Other measurable impacts including defence savings; impacts on the financial sector and defence procurement; loss of support for the renewable energy sector and the set-up costs of new government departments.

Several important factors are not included because of a lack of authoritative and empirical data supporting objective analysis. While they are discussed qualitatively, they do not contribute to the final tally. These include behavioural changes by taxpayers and businesses (for example, in response to tax increases and spending reductions); market reaction to independence; changes in economies of scale in industries and retail; and productivity changes.

Where the data points to a range of outcomes, a scenario more favourable to independence is typically used. Since most of the economic considerations do not favour independence, this approach means that the overall impacts set out in this study are likely to represent a cautious estimate of costs.

A question of timing

There has been a good deal of discussion on the timing of new policies and key decisions facing a newly independent Scotland. For example, when Scotland might join the EU, launch its own currency, negotiate a trade deal with the remaining parts of the UK or close military bases.

In practice, the implementation of independence will vary across different policy areas. Predicting likely timescales is impossible as the timing of decision making will be contingent on a range of policies and trade-offs (as evidenced by Brexit negotiations).

This study takes the approach that the main impacts of independence would be felt from the outset. In some cases this benefits the case for independence. For example we assume that Scotland would quickly launch a new currency, cut defence spending and join the EU. The quid pro quo is that fiscal consolidation would also happen rapidly, along with the imposition of any new barriers to trade.

A newly independent Scotland's government would no doubt seek to delay or stagger many of the impacts set out in this report, as demonstrated through the Brexit journey. Modelling the timing of complicated events would make little difference to the overall value of the impacts. In the end, an independent Scotland would need to deal with these impacts at some stage.

1 Executive summary

Our approach

1.1 This report sets out an overall analysis of the likely economic and social impacts of independence. It uses modelling techniques and data widely accepted by economists in Scotland and elsewhere. The report considers the three major factors in the economics of Scottish independence in turn, with a fourth section covering a variety of other considerations:

- Currency arrangements in an independent Scotland;
- The fiscal position;
- Trade;
- Other factors including defence savings, the financial sector, support for the renewable energy sector and set-up costs.

1.2 Several important factors are not included because of a lack of authoritative and empirical data. Where the data points to a range of outcomes, a scenario more favourable to independence is typically used. The outcome is therefore cautious and can be seen as the minimum impact of independence.

Currency

1.3 There are five options for an independent Scotland's currency:

- A formal sterling currency union with the remaining parts of the UK (rUK).
- Joining the eurozone.
- Continuing to use sterling without formal agreement with rUK (sterlingisation).
- A new Scottish currency pegged to another currency (or set of currencies).
- A new Scottish currency allowed to float freely against other currencies.

1.4 Arrangements within a sterling currency union and the euro zone would require the agreement of the UK government and European Union respectively. These arrangements can be ruled out for the time being.

1.5 Policy makers are unlikely to advocate sterlingisation as the policy of choice for an independent Scotland. It would not allow the use of monetary policy in support of the economy or financial system and this report does not consider this scenario.

1.6 It is difficult to see beyond a currency arrangement where Scotland launches and uses its own, freely floating currency. It would maximise Scotland's monetary policy options and fits best the likely political scenarios on independence.

1.7 However, launching a new currency with Scotland's current very high fiscal deficit would expose the country to risks of a depreciating currency, devalued assets, higher inflation and interest rates.

1.8 There is a quid pro quo between stable currency arrangements and sound finances. The main costs of new monetary arrangements are implicit in necessary fiscal consolidation, covered below. Additionally, a newly independent Scotland would still need to borrow around £10 billion each year and would pay a premium of nearly £100 million each year.

Fiscal consolidation

1.9 GERS remains the best source of information for exploring the finances of a newly independent Scotland. The white paper, Scotland's Future (Scottish Government, 2013), used GERS as the "starting point" for analysis describing GERS as "the authoritative publication on Scotland's public finances."

1.10 GERS shows the average net fiscal balance over the last ten years accounted for -10.9% of Scotland's economy (-12.9% excluding the North Sea). The corresponding figure for the UK was -5.2%. An independent Scotland would need to reduce the net fiscal balance to a share of the economy at least to the point where it was similar to the UK, moving from -10.9% to -5.2%.

1.11 Fiscal consolidation, through reduced government expenditure, would result in a loss of £15.7 billion of output, £9.6 billion of Gross Value Added (GVA), £6.4 billion of income (wages) and 164,900 Full-Time Equivalent (FTE) jobs.

1.12 It is likely that a more balanced approach to fiscal consolidation would be adopted with combining reduced public expenditure with tax rises. The combined impacts of the balanced fiscal consolidation result in a loss of £14.2 billion of output, £8.6 billion of GVA, £5.5 billion of income and 149,000 FTE jobs.

1.13 Job losses are likely to impact deprived communities disproportionately. Dundee is projected to be the most adversely affected local authority area with 70 jobs lost for every 1,000 jobs currently in the city. West Dunbartonshire is the next most adversely affected area with 66 jobs for every 1,000 jobs in the local area.

Trade

1.14 The Scottish Government's policy is for an independent Scotland to join the EU to gain access to the European single market. This study assumes that Scotland would achieve rapid EU membership in line with these aspirations. However, this would mean facing barriers with the remaining parts of the UK similar to the UK's current barriers to trade with the EU.

1.15 Exports to the rest of the UK account for nearly two thirds of Scotland's exports. Scotland's' economy would therefore be affected by increased costs to trade across the border following independence.

1.16 In 2021 the London School of Economics published a study on the trade impacts of both Scottish independence and Brexit. They used similar methodologies to those used by both HM Treasury (2013) and by the Scottish Government (2019) measuring the trade costs to Scotland of Brexit, and the results are broadly proportionate to the findings in those studies.

1.17 This study takes an average of the scenarios outlined in the LSE study (-5.6%) and uses it to adjust exports in the Scottish Government's macroeconomic impact model.

1.18 The trade impacts would result in a loss of £13.3 billion of output, £6.7 billion of Gross Value Added (GVA), £4.0 billion of income (wages) and 98,100 Full-Time Equivalent (FTE) jobs.

1.19 Aberdeenshire is projected to be the most adversely affected local authority area with 46 jobs lost for every 1,000 jobs currently in the area. Clackmannanshire, the Western Isles and Dundee are projected to face the lowest relative job losses.

Other impacts

1.20 In line with smaller NATO countries' defence spending, Scotland could save £900 million each year. Analysis shows that financial and professional services would reduce in an independent Scotland as some firms were forced to relocate to retain their UK customer base and regulatory support. This equates to a loss of around £1.0 billion and 12,000 jobs.

Overall impacts

1.21 The overall costs amount to £29.2 billion of output, £16.3 billion of Gross Value Added (GVA), £9.9 billion of income (wages) and 253,000 (Full-Time Equivalent) jobs. The impact on GVA is equivalent to nearly ten per cent of Scotland's economy (excluding the North Sea) and nearly eleven per cent of jobs in Scotland.

Impact	Output	GVA	Income	Jobs
Fiscal consolidation	-£14.2	-£8.6	-£5.5	-149,000
Trade	-£13.3	-£6.7	-£4.0	-98,000
Financial services	-£2.2	-£1.0	£-0.5	-12,000
Defence	+£0.9	+£0.5	+£0.3	+9,000
Set up costs	-£0.2	-£0.1	-£0.1	-2,000
Other (currency and energy)	-£0.2	-£0.1	-£0.1	-1,000
Total	-£29.2	-£16.3	-£9.9	-253,000

(£s in billions)

2 Currency arrangements

Currency choices

2.1 The National Institute of Economic and Social Research (NIESR) described the choice of currency as "fundamental to the economics of independence." (Armstrong & Ebell, 2013). The currency arrangements of an independent Scotland will determine monetary policy, exchange rates, exposure to financial sector risks and key aspects of fiscal and economic policy.

2.2 More recently, the Institute for Government assessed the currency options for an independent Scotland (Tetlow & Soter, 2021a). Although much has changed since the 2013 report, the currency options considered by the Institute for Government and NIESR remain broadly the same. The five options considered by the Institute for Government can be summarised as followsi:

- Creating a formal sterling currency union with the remaining parts of the UK (rUK).
- Joining the eurozone.
- Continuing to use sterling without any formal agreement with rUK.
- A new Scottish currency pegged to another currency (or set of currencies).
- A new Scottish currency allowed to float freely against other currencies.

2.3 Each currency arrangement offers different strengths and weaknesses. NIESR (2013) stated that in their view, "no currency option is best when considered against all criteria" and advocated a rational assessment comparing the consequences of the various options.

2.4 Credible arrangements within a sterling currency union and the euro zone would require the agreement of the UK government and European Union respectively. The Institute for Government (2021a) highlighted a lack of appetite from the UK government for a formal currency union and joining the eurozone would only be possible after several years "once Scotland had jumped through the necessary hoops". There is some debate about Scotland's obligations to join the eurozone as a future EU member, but it does not warrant further analysis in this report.

2.5 The Sustainable Growth Commission (SGC) suggested continued use of sterling after independence (2018). More recently, the Scottish Government (2022b) proposed that "on independence, Scotland would continue to use the pound sterling for a period before moving to our policy of adopting a Scottish pound."

2.6 The above reports appear to indicate that the Scottish Government advocates 'sterlingisation', or informal use of the pound, at least for a while. In terms of continued informal use of sterling, there are examples of long-term 'Dollarization' among microstates, but Scotland is hardly comparable. A small number of larger countries have also adopted the US Dollar, but this has usually been in response to an economic collapse with dollarization used to curb inflation and promote economic stability.

2.7 These examples involve developing countries. By contrast Scotland has a highly developed economy, with a sophisticated financial services system and broad range of goods and services exported to international markets. Informal use of another currency limits the use of domestic monetary policy. A Scottish central bank would be unable to set interest rates, could not act as a lender of last resort in support of the banking system, and could not intervene in times of economic stress (as the Bank of England did during recent crises).

2.8 Furthermore, it's difficult to see why a newly independent Scotland, with an ambition to rejoin the EU, would seek to informally use sterling. Apart from anything else, sterlingisation would effectively involve Scotland following monetary policy as set by the Bank of England, including interest rates. At present the Bank of England takes Scotland's economy into account when adjusting monetary policy, it would no longer have to do this if Scotland opted to use the pound sterling outside of a formal currency union.

2.9 For all these reasons, policy makers are unlikely to advocate sterlingisation as the policy of choice for an independent Scotland. Those advocating 'continued use of the pound' have been less than clear how this would work. It seems unlikely that a full prospectus would propose informal use of sterling for long and modelled scenarios are not considered in this report.

Currency of choice?

2.10 NIESR emphasised that countries with their own currency have greater policy freedom which allows them to pursue "exceptional monetary policy measures" to support their financial systems. NIESR also highlighted the risks of introducing a new currency, including the need for Scotland to substantially reduce its debt burden.

2.11 The SGC's final report (2018) stated that a new Scottish currency would be introduced, albeit once the time is right, and tests are met. The Scottish Government's position is that the new currency's launch would be guided by "criteria and economic conditions rather than a fixed timetable", but a new currency is clearly the preferred outcome.

2.12 If a new Scottish pound were pegged to sterling, it's possible that English and Scottish notes could be used in the same way as they are today. It would minimise currency transaction costs in trade with the remaining parts of the UK. Meanwhile Scotland would be able to print its own money and set interest rates, indeed these would be valuable and necessary levers to maintain any link with Sterling.

2.13 A new Scottish pound could be pegged to sterling, but this could be at potentially significant cost, particularly if the economic fortunes of Scotland and the UK diverged. The challenges and costs of setting up a new currency have been debated extensively including the amount of reserves needed to back a new currency and how a newly independent Scotland might work with the remaining parts of the UK.

2.14 The reserves needed to back any new currency would be substantial. The Scottish Government would need to absorb currency movements between the two currencies to ensure the continuing smooth flow between them, effectively insuring households and businesses against any shocks from currency movements.

2.15 This would probably require an independent Scotland to establish a substantial fiscal surplus relative to the UK, extending the scope of fiscal consolidation described below. So the cost of acting as a shock absorber is likely to run into billions of pounds and would be at the cost of public services and delivery, this would be a difficult decision for any new administration to make.

2.16 Any future currency arrangement should seek to balance costs and risks across households, businesses and the public sector. Maintaining the link between a Scots pound and sterling over the longer term would become a difficult balancing act, particularly if Scotland simultaneously strives to meet Europe's fiscal rules to rejoin the EU.

2.17 Aside from timing, once the first four options have been ruled out for the reasons summarised here, there is in fact not much room for disagreement about currency among supporters of independence. Criticisms levelled at the Sustainable Growth Commission report on currency reflect wider tensions around the need for a new blueprint for Scotland's economy and how radical this should be.

2.18 On one hand the Sustainable Growth Commission sets out a vision for an independent Scotland emphasising fiscal responsibility, raising productivity and rebuilding links with the European Union. Those advocating a more radical blueprint envisage an expanded public sector unrestrained by the need to balance the books and a slightly cooler approach to rejoining the EU.

2.19 Under either approach, it is difficult to see beyond a currency arrangement where Scotland launches and uses its own, freely floating currency. It would maximise Scotland's monetary policy options and best fits the likely political scenarios on independence.

2.20 However, the implications for Scotland of floating its own new currency while running a large fiscal deficit (and deficit on the current account of the balance of payments) are significant. Launching a new currency with Scotland's current very high fiscal deficit would expose the country to all the risks of a depreciating currency, devalued assets, higher inflation and interest rates as international markets considered the higher risks of a new currency backed by lower revenues.

2.21 An Economics Observatory report on Scotland's currency options (MacDonald, 2022a) suggested the fiscal deficit reflected in the overall balance of payments of a newly independent Scotland could result in a steep initial currency depreciation, with "knock-on implications for the value of assets and liabilities denominated in sterling". Professor MacDonald has recently provided several additional currency scenarios online.

2.22 The Institute for Government suggests that Scotland would need to follow fiscal policies that international markets would view as sustainable. It suggests that Scotland would need to reduce its deficit to around 3% of Gross Domestic Product (GDP) in "normal times". Tetlow & Soter (2012b) recognise this as a "substantial fiscal consolidation" of around 5% to 6% of GDP, relative to the current position.

2.23 This report therefore assumes fiscal consolidation involving reduced public expenditure and some tax rises, a necessary precondition for launching a new currency. This is likely to insulate a newly independent Scotland from the more significant currency related impacts.

2.24 This study is therefore based on the assumption that the major costs of launching a new currency are borne via necessary fiscal consolidation. There is a quid quo pro at the heart of the economics of Scottish independence with new monetary arrangements accompanied by a new fiscal balance. In other words, the stronger Scotland's fiscal position, the lower the costs of moving to a new currency. The impacts associated with fiscal consolidation are considered in the next section.

Currency costs

2.25 While fiscal consolidation would remove the major risks of launching a new currency, giving up sterling would still impose some costs on an independent Scotland. There would be additional costs of trade and investment from currency variations when switching between currencies. These are not assessed separately in this section but are included in the section on trade and investment.

2.26 Also, launching a new Scottish currency will shape a range of impacts across Scotland's banking system, including the costs of establishing a new central bank, new mechanisms to deal with the new currency within the sector, and what would happen to existing deposits in UK banks. It is difficult to quantify these in isolation so the assumption here is that these costs are encompassed in the overall set up costs of an independent Scotland that are dealt with in the final section of this report.

2.27 Additionally, an independent Scotland would face higher borrowing costs on newly issued debt stemming from a premium charged on international markets on the additional risk from dealing with a new currency with a smaller revenue base.

2.28 NIESR (2013) stated that under any reasonable division, Scotland would begin its independence with a substantial amount of debt. NIESR estimated that an independent Scotland even within a Sterling currency zone would face long-run average additional borrowing costs compared to the UK.

2.29 The Institute for Government provides estimates of the likely scale of additional borrowing costs (Tetlow & Soter, 2021b). It states that Scotland would face limits on how much it could borrow year after year and estimates that the interest rate on Scottish bonds could be around 0.4 to 0.9 percentage points higher than that of the UK. The report also estimates that a premium of 0.5 percentage points would result in spending an extra 0.5% of GDP on debt interest each year by the middle of the century.

2.30 The estimate of additional borrowing costs depends on how much an independent Scotland would borrow, and how a share of the UK's debt would be inherited. Historic debt inherited by a newly independent Scotland would be a matter for negotiation. The Sustainable Growth Commission (2018) plans for an independent Scotland include an annual contribution to "servicing of a net balance of UK debt and assets".

2.31 The premium over UK rates would be 0.4 to 0.9 percentage point, it is reasonable to estimate additional borrowing costs based on a 0.7 percentage point premium given that rates are now rising from historic lows. A newly independent Scotland would still need to borrow around £10 billion each year and would therefore pay a premium of nearly £100 million each year. The impact of this additional cost is modelled alongside the other impacts assessed in the final section of this report. encompassed in the overall set up costs of an independent Scotland that are dealt with the final section of this report.

A newly independent Scotland would still need to borrow around £10 billion each year

3 Fiscal consolidation

Scotland's current fiscal position

3.1 The latest estimate of Scotland's net fiscal balance was a deficit of £23.7 billion in 2021-22 (Scottish Government, 2022a). The net fiscal balance in 2021-22 was equivalent to -12.3% of the Scottish economy, including revenues from the North Sea. The UK's corresponding net fiscal balance was -6.1% of the economy.

3.2 The above figures are published annually as part of the Scottish Government's Government Expenditure & Revenue Scotland (GERS) report. The report includes revenues raised from Scotland, devolved and reserved taxation, and public expenditure for and on behalf of Scotland, devolved and reserved expenditure.

3.3 Debate over the strengths and weaknesses of GERS often creates much heat and little light. The Fraser of Allander Institute (FAI) published an article on the latest GERS "what does it really tells us" including a summary of the approach.

3.4 GERS remains the best source of information for exploring the finances of a newly independent Scotland. The FAI article (above) states that GERS sets the starting point for a discussion about choices, opportunities and challenges with those advocating new fiscal arrangements.

3.5 The white paper, Scotland's Future (Scottish Government, 2013), used GERS as the "starting point" for analysis describing GERS as "the authoritative publication on Scotland's public finances." GERS was also used to inform the starting fiscal position of an independent Scotland by the Sustainable Growth Commission (2018), and the recent paper Building a New Scotland (Scottish Government, 2022b).

Fiscal consolidation

3.6 The SGC projected that in 2021-22 an independent Scotland's inherited deficit would be 5.5% of GDP based on what the report described as "very conservative assumptions". This fiscal projection assumed savings on defence and other government spending programmes.

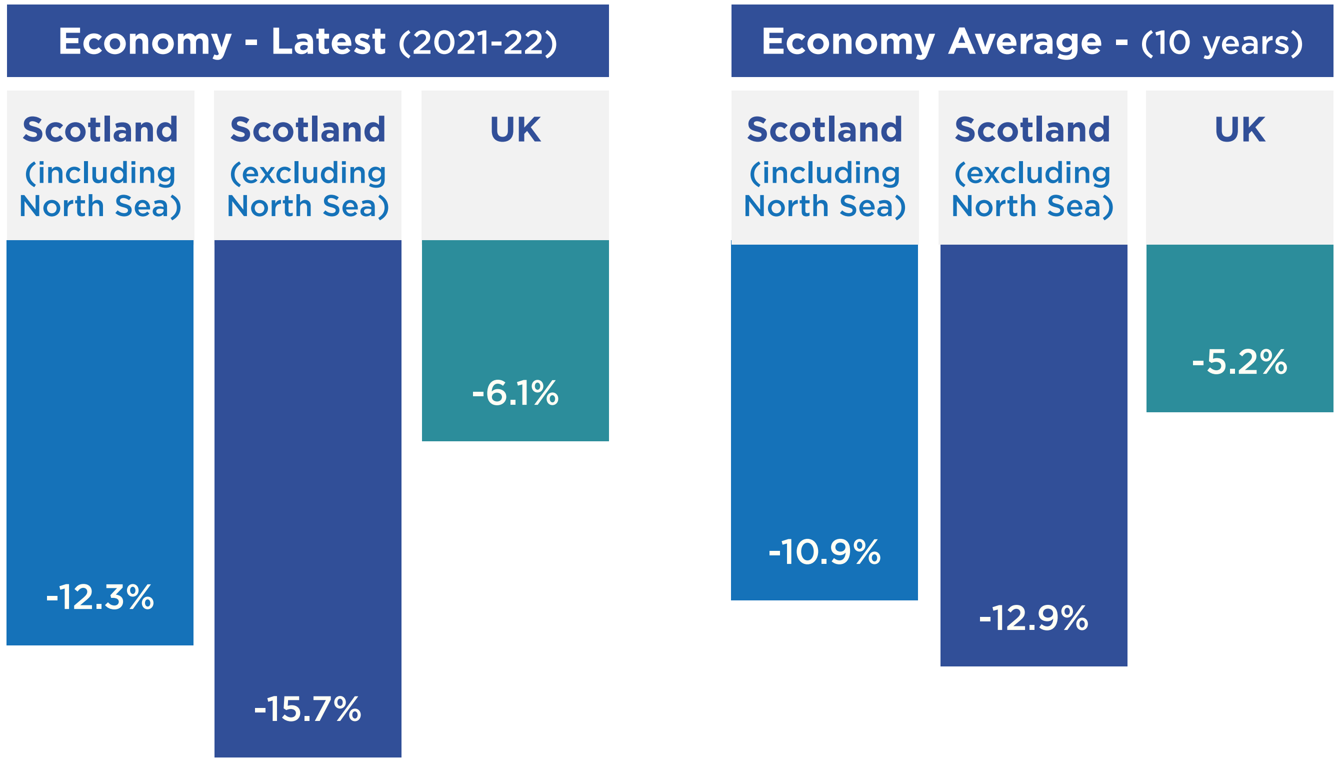
3.7 Allowing for 'solidarity payments' and excluding North Sea revenues, adjusted the projected 2021-22 fiscal deficit to 5.9% of GDP. The SGC report excluded North Sea revenues, set aside in a fund for future investment in inter-generational projects. This approach is similar to the more recent "Building a New Scotland Fund" proposals (Scottish Government, 2022b).

3.8 Even allowing for 'very conservative assumptions', Scotland's current fiscal deficit (12.3%) is more than double the SGC's projection (5.5%). However, the SGC report could not foresee the impacts of the global pandemic, war in Ukraine and subsequent pressures on the cost of living.

3.9 Scotland's current fiscal position reflects subdued revenues and higher public spending associated in part with the above challenges. However, it is reasonable to suggest that Scotland's net fiscal balance may improve over the next few years. This report uses a reasonable starting point based on the average net fiscal balance over the last ten years. This reflects an anticipated improvement in Scotland's current fiscal position and captures both challenging and benign years over the last decade.

3.10 GERS shows the average net fiscal balance over the last ten years accounted for 10.9% of Scotland's economy (12.9% excluding the North Sea). The corresponding figure for the UK' was -5.2%, shown in Figure 3.1. The average net fiscal deficit for all areas over the last ten years is lower than the current fiscal deficit.

Figure 3.1: Net fiscal balance (share of the economy)



Source: GERS (Scottish Government)

3.11 As discussed in the previous section, an independent Scotland would need to reduce the net fiscal balance to a share of the economy at least to the point where it was similar to the UK, moving from 10.9% to 5.2%. This is near to the 5.5% SGC target set in 2018, (5.9% allowing for solidarity payments and excluding North Sea revenues). It is also broadly in line with the Institute for Government assessment referenced in the previous section (Tetlow & Soter 2012b).

3.12 Reducing the net fiscal deficit by 5.7% involves improving the fiscal balance by **£10.9 billion** (2021-22), based on the latest GERS figures. Both the SGC and the Building a New Scotland paper propose using oil and gas revenues to build a long-term investment fund with the SGC report adjusting the projected fiscal balance accordingly.

3.13 In this report no adjustment is made to account for redirecting oil and gas revenues. This allows a more generous assessment of the fiscal consolidation required from an independent Scotland's point of view.

3.14 This study assumes that an independent Scotland would inherit its existing spending commitments in full. There has been significant commentary suggesting that the remaining parts of the UK would continue to pay various welfare entitlement, in particular the state pension, to those living in an independent Scotland. However, these comments do not appear to be based on convincing evidence.

3.15 The Scottish Government (2022b) recently stated that Scottish revenues are currently "sufficient to cover all devolved day-to-day services, all social security, including state pensions, and public sector pensions." This suggests the Scottish Government plans to meet the state pension obligations.

3.16 The above Scottish Government statement is similar to the position set out earlier by the Sustainable Growth Commission (SGC, 2018) "taxation raised in Scotland would be sufficient to pay for all services currently devolved and to meet all pensions and social benefits currently paid in Scotland by the UK Government."

3.17 The cost of state pension is captured within the fiscal consolidation modelling set out in this report. There are likely to be further costs with Scotland's population ageing more quickly than the rest of the UK, potentially incurring additional state pension costs. These costs are not considered here.

The impacts of fiscal consolidation

3.18 Government spending forms a significant part of final market demand driving Scotland's economy along with consumer spending, investment and exports. After accounting for imports, these components are used to measure Gross Domestic Product (GDP) by the expenditure approach. The Office for National Statistics (ONS) Guide to National Accounts provides an overview of this.

3.19 By reducing spending, fiscal consolidation would directly remove activity from Scotland's economy and reduce activity further still as supply chains are lost with reduced wages and job losses. These effects are captured by the Scottish Government's macroeconomic impact model (Scottish Government, 2022c).

3.20 The Scottish Government's model is frequently used to measure the wider economic footprint of public sector spending and investment and other policy measures, for example the consumption based carbon assessment of the Scottish Budget (2022-23). Impact analysis of this kind is a tool used widely in assessing public policy impacts in Scotland, the UK as a whole and across the EU.

3.21 The latest macroeconomic impact model (published October 2022) shows the final consumption expenditure in Scotland for central government (including UK and Scottish Governments), local government and non-profit institutions serving households (including Universities and Colleges).

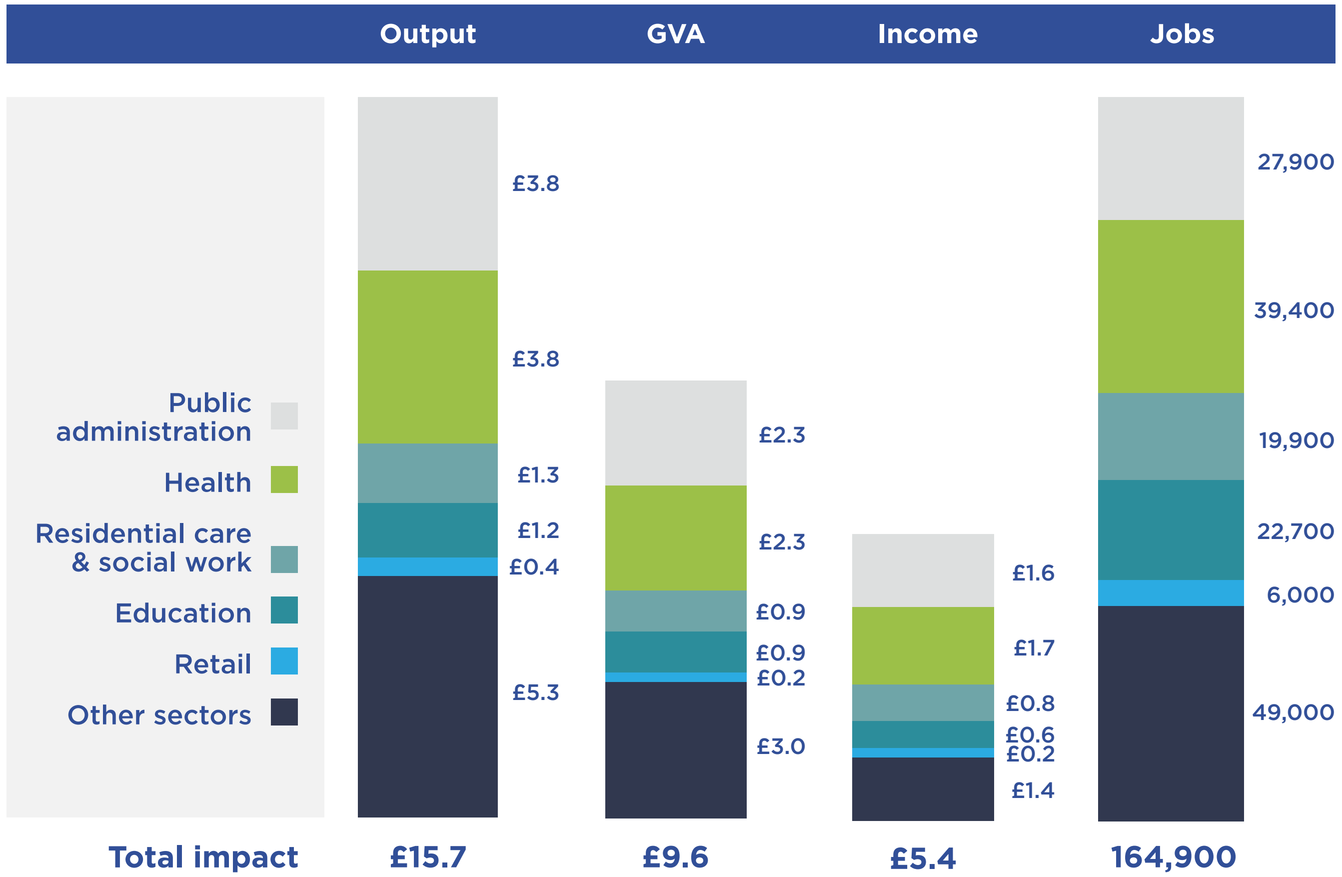
3.22 This study allocates the fiscal consolidation effect to the macroeconomic impact model's final consumption expenditure according to the relative size of each of the model's three demand components (above): central government spending (60%), local government spending (31%) and spending by non-profit institutions (9%).

3.23 These three broad components of demand are spread across nearly 100 different industrial sectors of the Scottish economy. The impacts capture the direct impact and indirect (supply chain) impactsii resulting from reduced public sector spending.

3.24 Figure 3.2. shows that fiscal consolidation, through reduced government expenditure, would result in a loss of £15.7 billion of output, £9.6 billion of Gross Value Added (GVA), £6.4 billion of income (wages) and 164,900 Full-Time Equivalent (FTE) jobs.

3.25 Figure 3.2 shows the five sectors bearing the most significant impacts of fiscal consolidation. Together these sectors accounted for around two thirds (67%) of the impact on GVA, 70% of jobs and more than three quarters of income (77%). These figures reflect the labour intensive nature of public services. For example, the latest data shows employment costs accounted for 69% of hospital costs (NES, 2022).

Figure 3.2: Fiscal consolidation through reduced spending (£s in billions)



Balanced fiscal consolidation

3.26 Under the scenario shown in Figure 3.2 some sectors, including health services and education, may contract by up to 7%. However, it is unlikely that the loss of nearly 40,000 heath jobs would be a credible option politically for a newly independent Scotland. This loss would be greater than all employment at NHS Greater Glasgow and Clyde or NHS Tayside and NHS Lothian combined[iii].

3.27 It is likely that a more balanced approach to fiscal consolidation would be adopted combining reduced public expenditure with tax rises. The latest Scottish Fiscal Commission (SFC) and Office for (OBR) reports allow an analysis of which taxes might be used by an independent Scotland consolidate its fiscal position.

3.28 It is difficult to estimate the additional revenues from changes to income tax and national insurance. This could be achieved in several ways, for example by expanding the tax base, lowering tax bands, or raising the rates of income tax and national insurance.

3.29 Such increases would generate knock-on effects where taxpayers decide to work fewer hours or change employment status thus reducing anticipated additional tax revenues. In this study, the scenario of balanced fiscal consolidation therefore focuses on taxes on assets and consumption which are arguably less likely to generate major behavioural changes.

3.30 These taxes are considered in terms of the overall additional revenue required. It is assumed here that most of the 'balanced' fiscal consolidation would be achieved through reduced spending, but some could be balanced by raising revenues.

3.31 The assumption is that the scope of council tax revenues is expanded (by one third), tobacco and alcohol tax revenues are increased by one third and revenues from Land and Buildings Transaction Tax (residential) are doubled. Alternative proposals for changes in taxes are possible.

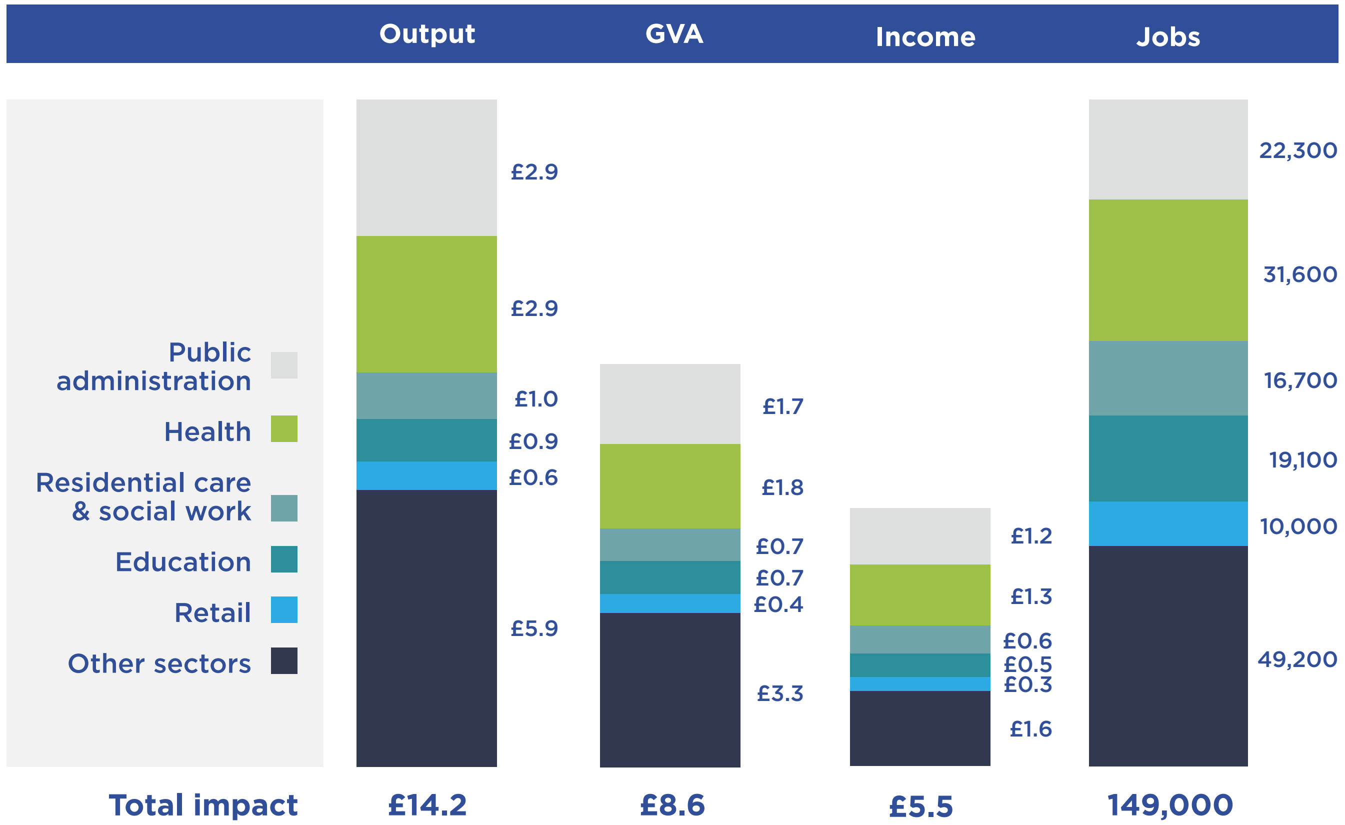
3.32 Based on the latest GERS data, these tax rises would raise an additional £2.7 billion in tax revenues meaning that public sector spending would only need to fall by £8.2 billion. The impact of reducing public sector spending by £8.2 billion is measured using the same approach to set out the impacts shown in Figure 3.2.

3.33 The additional £2.7 billion tax revenues are assumed to reduce household expenditure in Scotland. The combined impacts of the balanced fiscal consolidation are shown in Figure 3.3. This scenario shows a loss of £14.2 billion of output, £8.6 billion of GVA, £5.5 billion of income and 149,000 FTE jobs.

3.34 The macroeconomic impacts of balanced fiscal consolidation (Figure 3.3) are lower than simply reducing public sector spending (Figure 3.2). This is partly because some of the lost household spending would have flowed out of the Scottish economy through the purchase of imported goods and services.

3.35 Again, this report makes no assumptions about behavioural changes that would flow from tax increases and spending reductions. Behavioural responses would reduce anticipated additional revenues making the task of fiscal consolidation more challenging.

Figure 3.3: Balanced fiscal consolidation (£s in billions)



3.36 Job losses in the retail sector rise by around two thirds in the balanced fiscal consolidation scenario. This is because resources are effectively shifted from high street spending by consumers to supporting public services. The overall impact on jobs and income is lessened because, as described earlier, employment accounts for a relatively higher share of the costs of delivering public services compared to the private sector.

Other consequences of fiscal consolidation

3.37 However, a balanced approach has the overall effect of insulating relatively well paid public sector jobs at the expense of less well paid jobs in the private sector. This would be likely to raise income inequality in an independent Scotland.

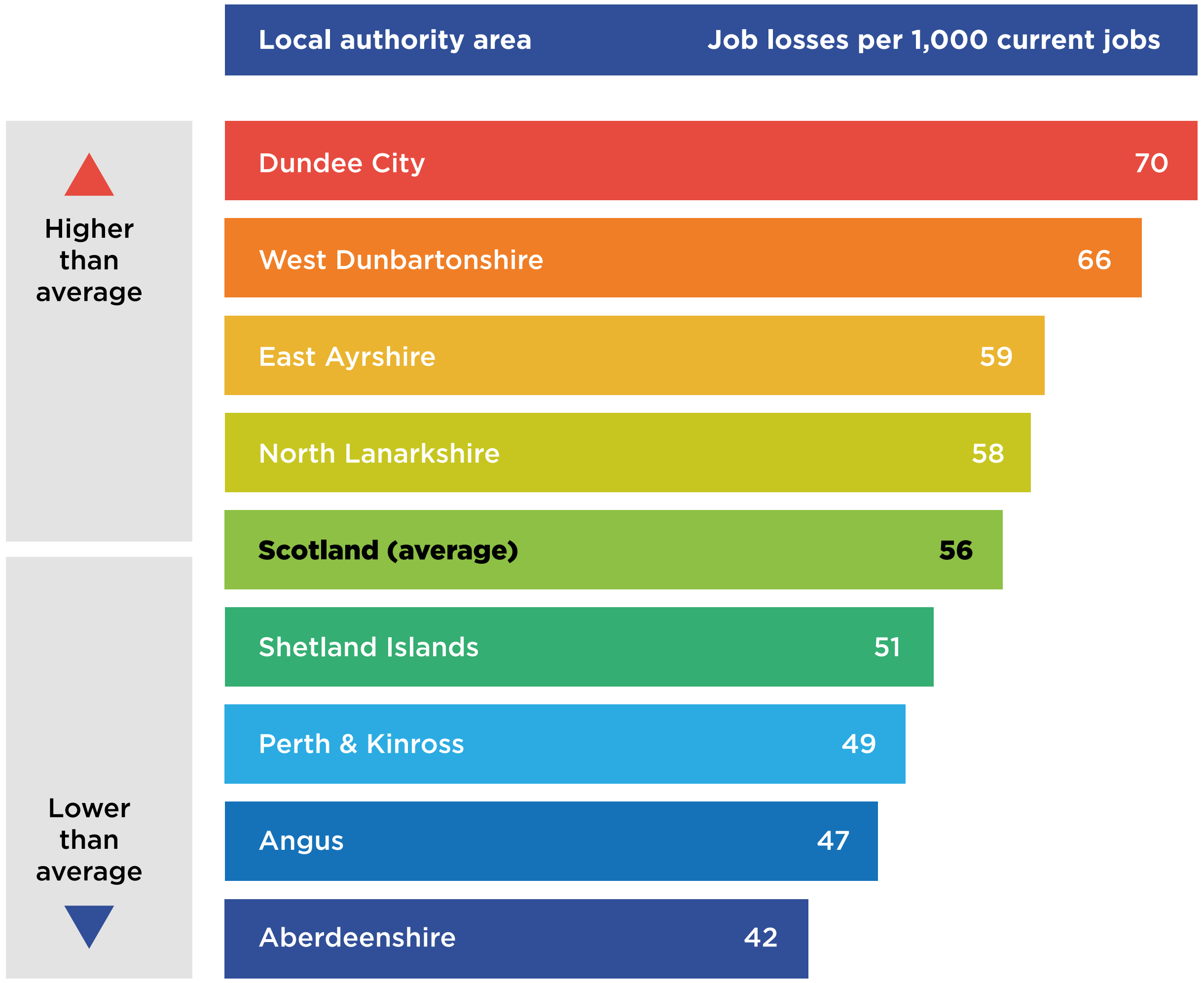
3.38 The latest Business Register and Employment Survey (BRES) data (2021) was used in this study to provide employment profiles for each of Scotland's local authority areas. The profiles were based on the industrial sectors of the impact model, setting out the share of Scottish employment within each sector for each local authority area. This allowed an estimated allocation of the economic impacts of fiscal consolidation.

3.39 Of the 149,000 jobs lost in our balanced fiscal consolidation scenario, the Glasgow City Council area was projected to suffer the largest impact with 25,000 job losses (17% of the total losses) followed by the City of Edinburgh area with 21,000 job losses (14%). Taken together, Scotland's two largest cities account for nearly one third (31%) of job losses from fiscal consolidation.

3.40 The above figures reflect the relative size of the Glasgow and Edinburgh economies. Figure 3.4 shows the projected job losses for selected local authorities per 1,000 jobs within each local authority (based on BRES data). This considers the relative size of each local authority.

Of the 149,000 jobs lost in our balanced fiscal consolidation scenario, Glasgow was projected to suffer the largest impact with 25,000 job losses

Figure 3.4: Projected job losses per 1,000 workers



3.41 Job losses are likely to disproportionately fall across deprived communities. Dundee City is projected to be most adversely affected local authority area with 70 jobs lost for every 1,000 jobs currently in the city. West Dunbartonshire is the next most adversely affected area with 66 jobs lost for every 1,000 jobs in the local area.

3.42 Aberdeenshire is projected to face the lowest relative job losses with just 42 job losses for every 1,000 jobs currently in the local area. Angus (47) and Perth & Kinross were projected to face the lowest relative impacts after Aberdeenshire.

3.43 The latest Scottish Index of Multiple Deprivation (SIMD) report shows that 38% of local communities (data zones) in Dundee City are categorised as among the most deprived in Scotland (falling within the top 20% of local communities suffering from the highest relative multiple deprivation). Relative deprivation was also high in West Dunbartonshire (40%), North Lanarkshire (35%) and East Ayrshire (31%).

3.44 In sharp contrast the areas least affected by projected job losses were among those least affected by relative deprivation. In Aberdeenshire just 3% of local communities were among the most relatively deprived in Scotland. Relative deprivation was also low in Angus (8%), Perth & Kinross (6%) and Shetland (<1%).

4 Trade

Trading arrangements

4.1 The trading relations of an independent Scotland have been a major element of the constitutional debate. The UK's exit from the European Union added a further dimension to this. As set out earlier in this report the Scottish Government's policy is for an independent Scotland to join the EU to gain access to the European single market (Scottish Government, 2022b).

4.2 While there is lively debate about how quickly (and if) this could be achieved, this study assumes, in line with its cautious approach to assessing the impacts of independence, that Scotland would achieve rapid EU membership in line with these aspirations. However, this would mean facing barriers with the remaining parts of the UK similar to the UK's current barriers to trade with the EU.

4.3 A recent Economics Observatory article (Roy & McIntyre, 2022) noted that if an independent Scotland sought to rejoin the EU's single market or customs union, then "it would have to contemplate an economic border between Scotland and the rest of the UK". The article also noted that examples like Ireland show it is possible to shift trade to new markets, but such changes take time.

4.4 Sampson (2022) notes that if Scotland became an independent country, "there would be a new international border with the rest of the UK. The additional costs that are inevitably created by borders would affect trade, making it harder for Scottish firms to do business with the rest of the UK."

4.5 Additional trading costs for businesses reduce trade between countries. Most sources of data suggest that the rest of the UK accounts for most of Scotland's exports. Sampson (2022) estimates that the rest of the UK accounts for over 60% of Scotland's exports.

4.6 The latest Input-Output tables for the Scottish economy (Scottish Government, 2022c) show that the rest of the UK accounts for nearly two thirds of Scotland's exports. Scotland's economy would therefore be affected by increased costs to trade across the border following independence.

Trade & investment

4.7 Borders can impose additional costs on businesses seeking to trade between countries or invest abroad arising from quotas, tariffs, red tape, regulatory differences and other factors. Free trade arrangements and customs unions, for example between the EU countries, can help to lower costs and promote trade.

4.8 Scotland has a small and open economy that is reliant on trade with other parts of the UK and international trade. As noted earlier the rest of the UK accounts for more Scottish exports than all other countries combined (around four times the size of trade with the EU).

4.9 In 2021 the London School of Economics published a study (Huang et al) on the trade impacts of both Scottish independence and Brexit. They used similar methodologies to those used by both HM Treasury (2013) and by the Scottish Government (2019) measuring the trade costs to Scotland of Brexit. The results are broadly proportionate across the studies with similar approaches.

4.10 Huang et al (2021) show that an independent Scotland would face a new international border with the remaining parts of the UK, imposing additional costs of trading with the rest of the UK. The report suggests that costs will increase even if Scotland and the UK were able to reach a trade agreement similar to the EU's single market.

4.11 The Scottish Government's ambition of rejoining the EU would lessen the cost of trading with other EU countries. But this would result in further costs in trading with the remaining parts of the UK (including customs checks).

4.12 Huang et al (2021) find that together, Brexit and independence (without Scotland rejoining the EU) would reduce long-run Scottish income per head by 6.5% (optimistic scenario) to 8.7% (pessimistic scenario). The report concludes that the impact of independence will be two to three times worse for the Scottish economy than Brexit because of Scotland's greater reliance on trade with the rest of the UK than with the EU.

4.13 The report notes that these figures probably underestimate the losses caused by higher trade costs, as they do not account for wider effects of the loss of exports from Scotland's economy (for example, lower productivity).

4.14 The report shows that "Rejoining the EU would be preferable to maintaining a common economic market with the rest of the UK only if independence is sufficiently trade-destroying that the rest of the UK becomes a less important trade partner for Scotland than the EU." (Huang et al, 2021).

4.15 The effects of Brexit (two percentage points) were removed from the modelled estimates of Huang et al (2021). The remaining effects captured the impacts relating to Scottish independence in the optimistic scenario (-6.7%) and pessimistic scenario (-4.5%).

4.16 This study takes an average of these scenarios (-5.6%) and adjusts exports to the remaining parts of the UK in the Scottish Government's macroeconomic impact model. The detailed model shows Scotland's financial services sector accounts for the largest share of exports to the rest of the UK followed by the energy sector (electricity and gas) and the insurance and pensions sector.

4.17 Figure 4.1 shows a summary of the modelled trade impacts. This would result in a loss of £13.3 billion of output, £6.7 billion of Gross Value Added (GVA), £4.0 billion of income (wages) and 98,100 Full-Time Equivalent (FTE) jobs.

Figure 4.1: Trade impacts (£s in billions)

4.18 Figure 4.1 also provides indicative impacts for the five sectors bearing the most significant impacts of loss of trade. This is based on a broad assumption of a proportionate loss to the rest of the UK markets across all sectors. Together these sectors accounted for just under half of the output lost across the Scottish economy.

4.19 This reflects the deep and broad trading relationship between Scotland and the rest of the UK. The figures also reflect the more capital intensive nature of Scotland's export industries compared to the activities impacted by fiscal consolidation. The export related impacts show relatively higher losses in Gross Value Added (GVA) and Output and relatively lower job losses compared to the fiscal consolidation impacts.

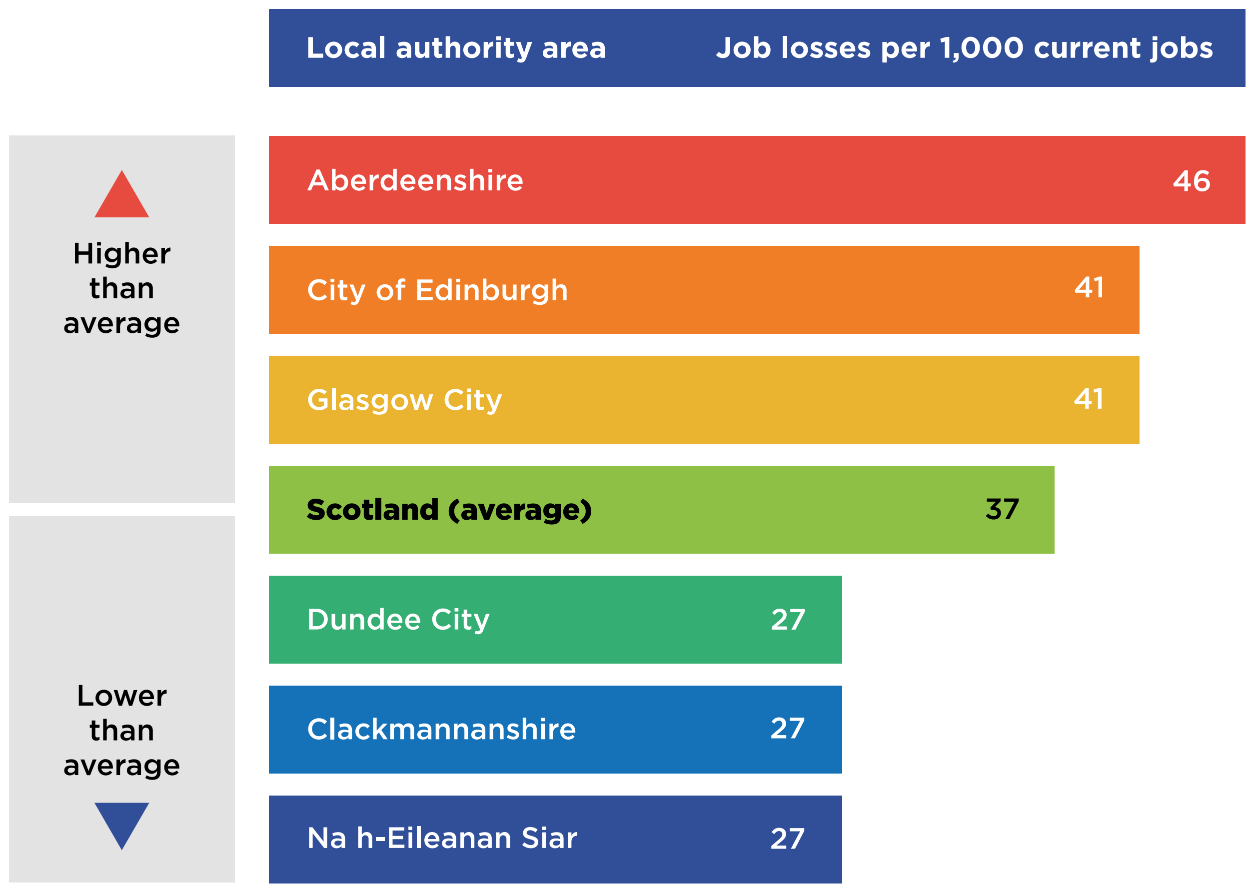
4.20 The same approach of using detailed industrial structures was used to allocate trade impacts across Scotland's local authority areas. Of the 98,000 jobs lost through trade impacts, the Glasgow City Council area was projected to suffer the largest impact with around nearly 18,000 job losses (18%) followed by the City of Edinburgh area with 15,000 job losses (15%). Taken together, Scotland's two largest cities account for one third (33%) of job losses from trade impacts.

4.21 The above figures reflect the relative size of the Glasgow and Edinburgh economies. Figure 4.2 shows the projected job losses for selected local authorities per 1,000 jobs within each local authority (based on BRES data). This considers the relative size of each local authority.

4.22 Aberdeenshire is projected to be the most adversely affected local authority area with 46 jobs lost for every 1,000 jobs currently in the area. This reflects Aberdeenshire's strengths in food and drink, energy and engineering. Scotland's two largest cities are the next most adversely affected areas reflecting losses in financial and business services.

4.23 Clackmannanshire, the Western Isles and Dundee are projected to face the lowest relative job losses. This likely reflects relatively poorer performance in export markets compared to other local economies.

Figure 4.2: Projected job losses per 1,000 workers



5 Other measurable impacts

Defence in an independent Scotland[iv]

5.1 The Royal United Services Institute (RUSI) report, A'the Blue Bonnets, arguably remains the most thorough examination of the resources and costs required to defend an independent Scotland (Crawford & Marsh, 2012). An update to the RUSI report was published by the Scottish Centre on European Relations (SCER) in 2018 considering the work of the Sustainable Growth Commission.

5.2 There is, for understandable reasons, limited information on the current defence costs incurred by Scotland. The most relevant set of figures available are those produced by the Scottish Government as part of the annual GERS report (Scottish Government. 2022a).

5.3 Debate on the likely costs involved in defending an independent Scotland has often focused on assuming similar defences to those in neighbouring countries such as Ireland, Denmark or Norway. Defence costs have also been based on allocating a proportional share of the UK's current personnel and equipment.

5.4 Both above approaches are limited and risk the misallocation of assets, either squandering valuable resources better used elsewhere, or creating gaps in defence and undue risk to Scotland and its interests.

5.5 The RUSI report (Crawford & Marsh. 2012) considered the defence needs of Scotland and then described the likely armed forces required to meet those needs. This included an estimate of the costs of operating and maintaining the personnel and equipment.

5.6 Units of all three services (army, navy and air force) will 'initially be equipped with Scotland's share of current assets including ocean going vessels, fast jets for domestic air patrol duties, transport aircraft and helicopters as well as army vehicles, artillery and air defence systems. The model was predicated on an independent Scotland specialising and not trying to maintain a full spectrum military capability.

5.7 The RUSI report estimated defence spending at 1.3% of GDP. GERS figures show defence spending for Scotland at 2% of GDP before the pandemic. This rose to nearly 2.3% during the pandemic, as Scotland's economy contracted. The updated version of the RUSI report (2018) set out several new ways in which costs could be funded including leasing Scottish military bases to defence partners.

5.8 However, this would clearly remain below the North Atlantic Treaty Organization (NATO) goal of 2% of GDP. The current geopolitical situation seems to favour increased defence commitments among Western nations. Finland and Sweden have applied to join NATO and Germany has recently increased defence spending as a share of the economy (partly in response to the situation in Ukraine).

5.9 These movements are likely to place some upward pressure on the defence budget of an independent Scotland seeking to join NATO, which is the position of the SNP. If defence spending were slightly higher than set out in the RUSI report ,at 1.5% of GDP, this is still likely to provide a cost saving of 0.5% of GDP (around £900 million).

5.10 This assumption, that Scotland could spend just 75% of the NATO target on defence, is in line with the highly cautious approach taken in this study towards the costs of independence. It is broadly in line with the Sustainable Growth Commission report suggestion that in an independent Scotland defence spending would account for a lower share of the economy (1.6%) than the UK. This proposed spending is in line with other small European countries.

Banking & finance

5.11 Scotland's National Strategy for Economic Transformation (Scottish Government, 2022d) sets out an ambition to build world-leading industries where Scotland already has a global competitive advantage. The strategy identifies "financial and professional services" as a key industry where Scotland occupies a position of global leadership.

5.12 The Scottish Government's strategy (2022d) also recognises that the Scottish banking sector has changed significantly since the financial crisis. The strategy states that "there is now a smaller domestic banking sector with many of the major banks operating in Scotland as part of larger UK and international groups."

5.13 Scottish Financial Enterprise describe financial services as a lynchpin of Scotland's economy with Scotland hosting a vibrant and diverse international financial centre. A report on Scotland's financial and professional services (TheCityUK, 2021) showed a contribution of £13.6 billion (GVA) in 2019, approaching one tenth (9.2%) of the Scottish economy and supporting 153,000 jobs.

5.14 The evidence papers underpinning the Scottish Government's strategy (2022d), show Scotland's financial services sector contributed £14.2 billion (GVA) and supported 153,000 jobs in 2019.

5.15 The above report (TheCityUK, 2021) showed that financial and professional services accounted for the largest share of any UK country or region outside London. Excluding London and Scotland, financial and professional services accounted for 6.7% of the rest of the UK's economy.

5.16 The Treasury (2013b) stated that Scotland is "a strong and attractive location for financial services business." The Treasury's report references Scotland's reputation, skilled workforce and the high quality of Scottish universities. The report also found that Scotland's financial sector was aided by its location within the UK-wide regulatory framework, supported by the UK's larger economy and access to the integrated domestic market.

5.17 The Scottish banking sector is large relative to the size of Scotland's economy. The Treasury (2013b) estimated that Scottish banks had "assets totalling around 1254 per cent of an independent Scotland's GDP" (calculations available online). Scotland's relatively large and highly concentrated financial services are likely to face additional scrutiny over financial stability from markets in the event of independence.

5.18 The likelihood is that some firms would relocate to the remaining parts of the UK to remain within the UK's financial regulatory framework and retain access to a predominantly UK customer base. Others may move some functions, including headquarters.

5.19 The Treasury sets out scenarios in which firms, whilst retaining much of their Scottish operations, diversify or restructure with key functions moving outside of Scotland. Some of this impact is captured within the trade and investment impacts set out earlier in this report.

5.20 The restructuring and diversification effects were considered across each of the components in TheCityUK report (2021). This analysis suggests that an independent Scotland would retain its position as the area most reliant on financial and professional services outside of London, at 8.5% of the economy. This equates to a loss of around £1.0 billion and 12,000 jobs in (after adjusting to 2021 prices and accounting for the loss of financial services exports already included in the trade section of this report).

Engineering and defence procurement

5.21 The Treasury (2013d) found that UK defence spending maintains a substantial industrial footprint in Scotland from shipbuilding, aerospace engineering, defence electronics and electrooptical systems. The report highlighted that many MOD prime contractors maintained sites in Scotland employing large numbers of people across the country.

5.22 More recently the House of Commons Scottish Affairs Committee (2022) concluded that "Scotland is experiencing a new era of confidence and investment in the defence sector." UK Government spending on defence led to major investment in Scotland. The HMNB Clyde is undergoing a £1.6 billion infrastructure project with the number of jobs supported at the base expanding from 7,000 to 8,200 jobs.

5.23 The Scottish Affairs Committee found that Ministry Of Defence (MOD) spending with Scottish industry was close to £2 billion in 2020-21. This was almost 10% of total MOD's spending with industry across the UK with Scotland enjoying markedly higher MOD spending per head than other parts of the UK.

5.24 Defence expenditure and overall fiscal consolidation impacts are considered elsewhere in this report. Reduced defence procurement in Scotland is likely to impacts on supply chains in Scotland, particularly in engineering activities. These effects are difficult to quantify and are not considered in this report.

Renewable energy

5.25 The UK's energy markets result in a significant net subsidy paid into Scotland from the rest of the UK. The remaining parts of the UK would still need to purchase energy from an independent Scotland, but Scotland may not continue to benefit as generously from associated subsidies. It is likely the remaining parts of the UK would seek to refocus incentives to develop domestic (remaining parts of the UK) renewable energy production.

5.26 The government's main mechanism for supporting low-carbon electricity generation is through Contracts for Difference. The scheme encourages investment by supporting renewable energy projects with high upfront cost and long lifetimes. The Department for Business, Energy & Industrial Strategy (BEIS) recently published the latest phase of evaluation of the Contracts for Difference scheme.

5.27 The Office for National Statistics (ONS) publish annual estimates of the low carbon economy. The latest ONS figures show that during 2020 low carbon electricity business in Scotland had a turnover of £3.5 billion. Scotland accounted for more than a quarter (27.6%) of the UK's turnover in the low carbon electricity sector.

5.28 The latest BEIS data (December 2022) shows Scotland continues to transfer electricity other parts of the UK. In 2021 Scotland exported one third (33%) of its electricity generation in net transfers to England and Northern Ireland (exports were 37% of generation in 2020).

5.29 The above evaluation, energy reports and renewable energy generated in Scotland allows an estimate of the likely loss of UK-wide investment to support developers of renewable energy projects. A conservative estimate of £0.1 billion was used to represent the costs to Scotland from both the loss of support for developers in Scotland and access to the remaining parts of the UK market (to which Scotland is a significant and growing exporter).

Set up costs and economies of scale

5.30 The Treasury's Scotland analysis reports considered the costs of setting up the organisations and infrastructure needed to run an independent Scotland (HM Treasury, 2014). This included estimates for costs required to run the benefits system and the costs of creating a new tax regime in an independent Scottish state.

5.31 The report drew on independent analysis based on Quebec showing the costs of institutional restructuring for an independent Scotland. The Treasury estimated set up costs of 1% of GDP (£1.5 billion in 2012-13).

5.32 Alternative estimates suggested the initial set up costs may have been closer to £200 million. The Centre on Constitutional Change summarised a number of different reports and sources including Professor Iain McLean who stated that the estimates were "actually roughly the same" once definitional differences are accounted for with the costs "somewhere between £1.5 billion and £2 billion."

5.33 Based on the 1% of GDP estimate, set up costs for an independent Scotland would be around £1.7 billion. This is a cautious estimate falling within the scope of what would have been considered reasonable nearly ten years ago.

5.34 Set up costs for new government departments in an independent Scotland would be a 'one-off' cost, unlike most of the other impacts assessed here. It is therefore reasonable to assume that these costs would be spread over time (ten years) so that the first year costs would be around £170 million.

5.35 Some private sector industries are likely to lose economies of scale from having to run separate networks in an independent Scotland. Additional costs could arise from serving a smaller customer base, running separate distribution systems, different billing systems, and operating in a different regulatory regime.

5.36 Affected industries could include retail, utilities, and the postal network. However, it is also possible for an independent Scotland to find more efficient ways to deliver both public and private sector services. The effects of efficiency gains or loss of economies of scale cannot easily be measured and are excluded from this report.

Other impacts

5.37 This report considered additional borrowing costs, depending on how much an independent Scotland would need to borrow. This process is also partly reflected in some of the set up costs identified as a newly independent Scotland establishes new monetary agencies and infrastructure.

5.38 Inherited assets and liabilities will be a matter of negotiation. As highlighted earlier in this report the Sustainable Growth Commission (2018) cited the need for an independent Scotland to make an annual contribution to the servicing of the net balance of UK debt and assets, there is a broad recognition across that Scotland would inherit a fair share of liabilities. The assumption here is that Scotland's inherited debt will be proportionate to its population and that there are no significant economic costs or benefits from changes to the overall level of existing debt.

5.39 It is assumed a relatively smooth transition takes place with the remaining parts of the UK. However, lengthy negotiations or disagreement may lead to additional costs around trade and investment with the remaining parts of the UK or place additional costs on a newly independent Scotland's ability to borrow from international markets and sustain a stable monetary environment. These scenarios are not considered within this report.

5.40 Additionally, there are considerations over the initial value of a new Scottish currency relative to sterling (and other currencies). The appropriate fair value of a new Scottish currency is discussed by Professor MacDonald (2022b) where the fair value may involve a Scots pound being worth significantly less than a pound sterling.

5.41 An independent Scotland may seek to minimise the implications of devaluation or depreciation of assets and liabilities with a separate currency. The larger the extent of fiscal consolidation (moving towards a fiscal surplus) the less the devaluation would need to be.

5.42 The value of a currency is dependent in part on a country's fiscal position reflected in its overall balance of payments. This report makes the optimistic assumption that with the level of fiscal consolidation envisaged (achieving a fiscal deficit equivalent to that of the UK) means that further significant currency costs (post-launch) are unlikely to be imposed on trade and investment. Once launched, a new Scottish currency would broadly maintain its value relative to sterling, given the fiscal consolidation outlined in this report.

5.43 As described above, if the new Scottish currency were to be pegged to sterling (or other currencies) then significant new costs would be involved. A country with a fixed rate is likely to need to run a fiscal surplus to build up sufficient reserves to make such a system credible; Theoretically, floating exchange rates do not need any foreign exchange reserves, although in practice countries with floating rates tend to have significant reserve holdings.

If the new Scottish currency were to be pegged to sterling (or other currencies) then significant new costs would be involved

6 Total impacts

Overall impact of Scottish independence

6.1 Figure 6.1 summarises the impacts set out earlier in this report. The impacts of fiscal consolidation (balanced) and trade were modelled using the Scottish Government's macroeconomic impact model (for output, GVA, income and jobs) as described earlier.

6.2 The impacts on financial services, defence, set up costs, currency and energy are presented in terms of direct impacts only (without supply chain impacts). The indirect impacts were excluded as the significant retrenchment of public finances and trade (captured in the fiscal consolidation and trade impacts) are likely to have already captured part of the wider impacts with a fundamental change in the structure of Scotland's economy. If these wider impacts were included they would serve to increase the overall costs.

Figure 6.1: Overall impact of Scottish independence (£s in billions)

Impact	Output	GVA	Income	Jobs
Fiscal consolidation	-£14.2	-£8.6	-£5.5	-149,000
Trade	-£13.3	-£6.7	-£4.0	-98,000
Financial services	-£2.2	-£1.0	£-0.5	-12,000
Defence	+£0.9	+£0.5	+£0.3	+9,000
Set up costs	-£0.2	-£0.1	-£0.1	-2,000
Other (currency and energy)	-£0.2	-£0.1	-£0.1	-1,000
Total	-£29.2	-£16.3	-£9.9	-253,000

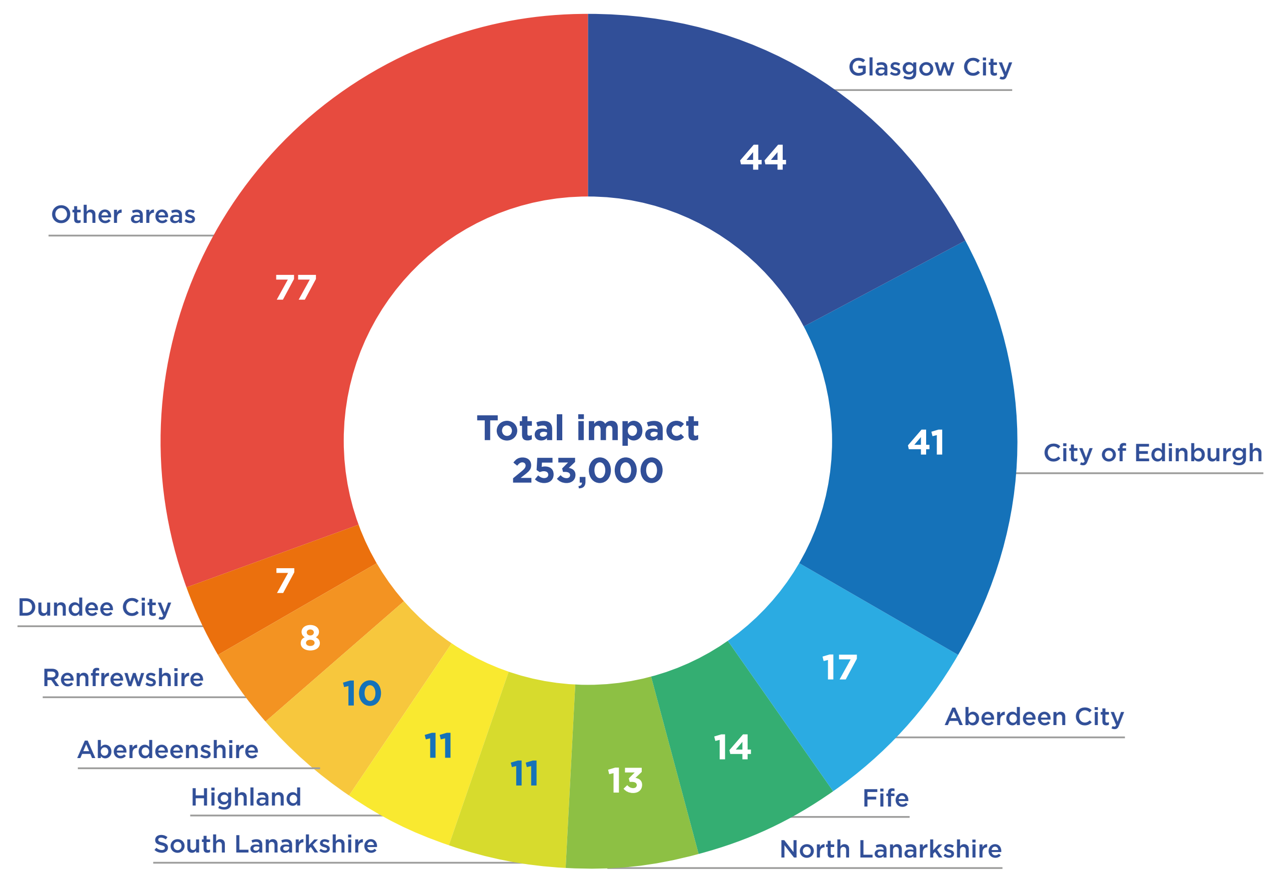
6.3 The overall costs amount to £29.2 billion of output, £16.3 billion of Gross Value Added (GVA), £9.9 billion of income (wages) and 253,000 (Full-Time Equivalent) jobs. The impact on GVA is equivalent to nearly ten per cent of Scotland's economy (excluding the North Sea) and nearly eleven per cent of jobs in Scotland.

6.4 The total impacts by industry are shown in Figure 6.2. Some of the impacts generated through fiscal consolidation are marginally mitigated through cost savings from lower defence expenditure. The greatest loss of economic output is likely to be felt in Scotland's financial services sector while nearly 90,000 jobs would be lost across public services (including local government), education, health, social work and residential care.

Figure 6.2: Total costs by industry (£s in billions)

6.5 Projected job losses by local authority area are shown in Figure 6.3. Glasgow is likely to suffer the largest number of job losses through the retrenchment of public services (including local government). Glasgow's position as a financial and business services hub also generates further potential job losses. Similarly, Edinburgh's financial services sector is projected to lose employment driving job losses.

Figure 6.3: Total change in employment by local authority (Jobs lost in 000s)



6.6 The above figures reflect the relative size of the Glasgow and Edinburgh economies. Figure 6.4 shows the projected job losses among the ten most affected local authority areas (per 1,000 jobs within each local authority). This considers the relative size of each local authority.

6.7 The greatest relative impact will be felt in Edinburgh followed by Aberdeen. While potential saving from reduced defence spending will mitigate the impact of fiscal consolidation for much of Scotland, West Dunbartonshire will experience a relatively high number of job losses.

Figure 6.4: Total job losses per 1,000 workers

Total job losses per 1,000 workers	
Jobs lost	**Area**
113.2	City of Edinburgh
106.2	Aberdeen City
104.4	West Dunbartonshire
103.7	Glasgow City
98.8	Inverclyde
98.6	Fife
97.2	Falkirk
95.3	Dundee City
95.1	Stirling
93.5	North Lanarkshire

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Notes

[i] NISER set out a sixth option covering informal use of the euro.

[ii] This is based on the Type I Input-Output model (capturing direct and indirect impacts) published by the Scottish Government. The multiplier effects are generally lower than the Type II model (capturing direct, indirect and induced impacts).

[iii] The latest TURAS Data Intelligence dashboard (March 2022) covering the NHSScotland workforce shows Whole Time Equivalent (WTE) employment of 36,000 for NHS Greater Glasgow and Clyde, 23,000 for NHS Lothian and 13,000 for NHS Tayside.

[iv] I am grateful to Stuart Crawford for his comments on defence costs.

> "A newly **independent Scotland would face significant challenges** in funding public services and maintaining trade with the remaining parts of the UK. A balanced approach to managing the economy would **involve the loss of nearly 90,000 jobs** across public services and a quarter of a million overall. This would also involve some property taxes doubling and **council tax expanding by a third**.

> "The **consequences of spending cuts** would fall disproportionately across Scotland's less affluent communities. The economies of Scotland's more successful **city economies would also contract** in the face of more **challenging trading conditions**."

- Richard Marsh, Director of 4-consulting and author of the Independence Uncovered report.

About Scottish Business UK

Founded by Robert D. Kilgour in 2017, with former Conservative MEP Struan Stevenson as CEO, Scottish Business UK (SBUK) is an independent, non-party voice for business leaders who want to see Scotland thrive economically as part of the United Kingdom.

As an organisation representing business leaders across a wide range of sectors and geographical areas in Scotland, SBUK has been a vocal and effective opponent of Scottish Government plans to hold a second referendum and stands ready to make the positive case for the UK in future national campaigns.

SBUK has a strong and diverse Advisory Council currently numbering some 60 high profile leaders from business, politics and journalism, who together employ more than 12,000 people in Scotland and over 35,000 UK wide. SBUK is a registered company known as 'SB Supports the Union Ltd'.

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