

Please note that this is BBC copyright and may not be reproduced or copied for any other purpose.

BBC
RADIO 4

CURRENT AFFAIRS

ANALYSIS
A SCOTTISH POUND?

TRANSCRIPT OF A RECORDED DOCUMENTARY

Presenter: Chris Bowlby
Producer: Mark Savage
Editor: Innes Bowen

BBC
New Broadcasting House
London
W1A 1AA

Broadcast Date:	28.01.13	2030-2100
Repeat Date:	03.02.13	2130-2200
CD Number:		
Duration:	27' 34"	

Taking part in order of appearance:

George Kerevan

Economist and Scottish National Party Member

Steve Davies

Historian and Education Director, Institute of Economic Affairs

Dr Angus Armstrong

**Director of Macroeconomic Research, National Institute for
Economic and Social Research**

Professor Philip Booth

**Editorial and Programme Director, Institute of Economic Affairs
Professor of Insurance and Risk Management, Cass Business School**

Charles Larkin

Research Associate, Trinity College Dublin

Rachel Lomax

Former Deputy Governor of the Bank of England

Patrick Harvie

Scottish Green Party Co-Convenor

BOWLBY: Scottish banknotes - cause of many an awkward moment when Scots arriving in England try to pay for a taxi. And a surprise too for the English heading north. (*Fx: café*) I've just done what many from the south do when visiting Scotland - a double take when the change for the coffee I've bought has come as an unfamiliar banknote. It's a reminder that monetary fusion in the UK was never as complete as we might assume; a separate Scottish tradition in banking and finance has always remained.

VOX POP (Scottish Female Voter): I don't know the history of Scottish money, so I presume it stems from when we were independent originally. I don't see anything wrong with having separate notes because even though we are all part of the United Kingdom, it still does give us our own identity, so I think it's quite nice to have different notes for the different countries.

BOWLBY: But if Scots do vote for independence next year, different money may be much more than a tourist curiosity. Who would run Scotland's money after independence? Who would guarantee its value? In an age of crashing banks and financial panics, it's an urgent question. History has shaped this too. A political deal over banks and banknotes was part of the original Anglo-Scottish union three centuries ago. George Kerevan, economist and Scottish National Party Member.

KEREVAN: There were Scottish banks before we had the Act of Union in 1707. One of the elements in the union treaty was to leave Scottish banks separate, and so they were allowed to print notes. Whereas in England, of course, private banks were not allowed to print their own notes. That became a monopoly of the Bank of England. Now these days the Scottish banks still issue their own notes, but they have to keep one for one the equivalent in sterling at the Bank of England, otherwise of course they'd just be able to print as many notes as they like with all the disaster that might result in.

BOWLBY: The Bank of Scotland, Royal Bank of Scotland and Clydesdale Bank who together with northern Irish banks can issue their own money may believe this derives from a reputation for canny thrift. But from London's point of view, there seems to be a whiff of suspicion. It's not only cabbies outside Kings Cross who look warily on Scottish cash. Steve Davies, historian at the Institute of Economic Affairs.

DAVIES: The way it works in practice is that there's a large kind of note deposited with the Bank of England which essentially amounts to a claim by the bank against the assets and currency issued by the Scottish Bank. So if ever they wanted to bring them under control, they could simply clear that large note against the note issue of the Scottish Bank. They could also withdraw the license to do it if they wanted to.

BOWLBY: So why the need for this kind of insurance policy: backing held partly in the form of the Bank of England's largest notes called giants - worth a million pounds - and titans - worth a hundred million? They're there in case Scottish money had to be withdrawn and replaced with standard Bank of England notes. These aren't things we usually think about as we trade our bits of currency paper, but it makes Scottish notes seem a bit more mysterious and

provisional.

DAVIES: These banknotes are technically not legal tender even in Scotland, which means that you cannot insist on their being accepted in payment for a debt. The creditor is perfectly at liberty to refuse this. But they're only issued under the basis of a licence and control from the Bank of England. They're no longer completely freely issued as they were before 1844.

BOWLBY: This system, with its giants and titans standing guard, seems to have worked well enough up to now. But if Scotland becomes politically independent, that raises new uncertainties. Could Scotland issue its own national currency with its own central bank, could other currencies begin to circulate, or could it do a new deal with London to stay part of sterling and keep everyone's faith in those familiar notes and the banks issuing them? Given the financial dramas of the last few years, everyone wants these things to be clear before they're put to the test.

ARMSTRONG: If there's one question in this whole independence debate that people have to get right, it is to be absolutely clear about what the currency arrangements are going to be between independent Scotland and the rest of the UK.

BOWLBY: Dr Angus Armstrong of the National Institute for Economic and Social Research knows what happens during financial crises - until recently he was a senior Treasury official in London. And he's spending a lot of time thinking through the implications of possible Scottish independence. We may, he suggests, be used to debate about Scotland focused on who gets oil resources or pays for social services. But currency is now crucial.

ARMSTRONG: If the currency options are not fully thought through and made absolutely clear where the responsibilities lie, then the most likely outcome is there'd be very serious problems down the road. So this issue is in my view the central question in Scottish independence.

VOX POP: BOWLBY: *If Scotland becomes independent, should it have its own money, its own currency?*

VOX POP (Scottish Female Voter): *Yes.*

VOX POP (Male Scottish Voter) *I don't know. Call me a traditionalist, but the ramifications of that don't bear thinking about, to be honest.*

BOWLBY: The debate about independence is intensifying here in Scotland. And what's noticeable on the nationalist side is that the appeal to separate Scottish identity comes with constant reassurance that some things won't change that much. Reassurance, for example, that the Queen will remain head of state, that Scots will still mix freely with the rest of the UK. And reassurance over the money in Scottish pockets - still to be, it's suggested, much as it was before - part of the sterling family. I could see why the nationalists have been rethinking things after conversations with potential referendum voters in Edinburgh. They confirmed recent opinion polls suggesting a substantial majority of Scots in

favour of keeping sterling come what may.

VOX POP: (Scottish Male Voter) *I don't see why we can't keep the pound sterling. I wouldn't want like to go into the euro, but I see no reason why we couldn't have some sort of arrangement with the Bank of England that would see us keep the pound.*

VOX POP: (Scottish Female Voter): *I think that Scotland can just do it on their own. I really, really do think that. And I think that things like the money, etcetera, may be an issue at the start or it could have issues, but it's something that we need to obviously manoeuvre.*

BOWLBY: *Because at the moment the SNP are talking about carrying on having sterling. Do you not like that?*

VOX POP: (Scottish Female Voter): *I think if we want to have our own independence, it's got to be from everything.*

VOX POP: (Scottish Male Voter): *Well I mean pound sterling for me, it's the same whether it's English from an English bank or a Scottish bank. I think if you start messing around with euro, sterling ... What would it be called - the Scot or ... I don't know.*

BOWLBY: This anxiety about monetary change has taken the Scottish National Party away from the older, simpler days when it had a more straightforward faith in Scots doing it for themselves. Economist and former SNP election candidate, George Kerevan.

KEREVAN: *If you go back to the early days of the Scottish National Movement, really from the 1930s through to the 1960s, I expect that the normal assumption would have been that Scotland would become a nation with a flag and embassies and an army and its own currency. There wasn't much in the way of deep thought about this or economic analysis; it was just one of the things that went with the territory of being independent.*

BOWLBY: Kerevan traces the changes in his party's thinking - away from the assumption that independence meant your own currency, through enthusiasm for joining the euro, to a new policy as the eurozone crisis worsened.

KEREVAN: *When the eurozone crisis happened, there was a bit of reluctance to rethink things because it opened up again the whole debate about what if Scotland had a separate currency, think how complex that would be in the political debate. So there was a quick rethink and I think that they came to the conclusion within the SNP leadership that the simplest option in the immediate aftermath of independence would be to stay within some kind of sterling currency union. I mean as I keep telling people you can't have a bourgeois revolution without the bourgeoisie, so you're not going to have independence without the business community backing it to some degree, and so the currency issue then becomes important and, therefore, how do you maintain trading relationships with the rest of the UK. You need some kind of currency solution.*

BOWLBY: This makes you realise how politics as well as economics is such a crucial part of the currency calculation. Nationalists didn't want voters fearing that Scotland could become, say, another Iceland by going it alone financially. So, current SNP policy after that 'quick rethink' is for an independent Scotland to continue to use sterling under Bank of England supervision - but with increased Scottish influence. Economic independence, it's argued, will be shown more in other ways, such as taxation policy. The Chancellor of the Exchequer George Osborne, however, suggested in a speech in September that London would not be inclined to co-operate.

OSBORNE: Extract BBC News 6 Sept 2012 (speech to Scottish CBI): The SNP's latest position is that an independent Scotland would seek to enter a formal monetary union within a sterling zone. But the conundrum of the eurozone crisis is how difficult it is to combine currency union with full fiscal and political independence. The members of the eurozone are now faced with what I've described as the remorseless logic, the very lesson of the eurozone crisis, that you can't have monetary union without greater fiscal and political integration.

BOWLBY: There've been suggestions that Scotland would have to apply to rejoin the European Union as an independent state, and as part of that would have to commit to joining the euro. The SNP disputes this, saying they see no prospect of joining the euro 'in the foreseeable future' and that euro membership would anyway still be subject to approval by the Scottish people. And if London won't co-operate, suggested SNP leader Alex Salmond last year, there's still nothing to stop the Scots from continuing to use sterling.

SALMOND: (Extract BBC News 15 Jan 2012): The UK government can't stop an independent Scotland using sterling. Sterling is a fully convertible currency. You couldn't possibly instruct people not to use sterling. I don't know what George Osborne's degree was in, but it certainly wasn't in economics.

BOWLBY: In case you're wondering, George Osborne studied history. Economics students could tell him though that there are countries - ranging from El Salvador and East Timor to Kosovo and Montenegro - that use another country's money. How can this work in practice? Professor Philip Booth of the Cass Business School is a former special adviser at the Bank of England

BOOTH: One obvious scenario is that Scotland set up what is known as a currency board and they either simply use the English pound in Scotland or possibly that they start to print and mint Scottish currency and hold English government securities and English currency to back every pound of Scottish currency that's produced. That's known as a currency board arrangement and that's the sort of approach that the Irish government took after independence.

BOWLBY: So you wouldn't necessarily have to have the cooperation of the Bank of England to do that?

BOOTH: No, you certainly don't have to have the cooperation of the Bank of England to do that at all. Any country in the world could decide to do that. The

Americans, if they wanted to, could decide to adopt the pound sterling using exactly that type of arrangement.

BOWLBY: So the Scots could offer their own guarantees for the notes they use - perhaps Tartan Titans stored in Edinburgh strong rooms? And Philip Booth's mention of Ireland suggests an intriguing historical precedent for this kind of thing in the history of sterling. After the Irish fought to gain political independence from London in the 1920s, they still kept close monetary links with British currency. Charles Larkin is a research associate of Trinity College Dublin.

LARKIN: When independence took place in 1922, the design was to create a currency board. And a currency board essentially means that you have a domestic currency, which would be considered an Irish pound, but that Irish pound would only be issued strictly with 100 per cent backing either in solid gold specie or in pound sterling notes. And as part of that, and as part of our agreement with the Bank of England, Irish pound notes that were issued in the 1920s, 30s and 40s would be redeemable at parity without any margin with the Bank of England.

BOWLBY: So a punt for a pound was the stable rate. The Treasury in London has been quietly studying this Irish precedent - part of serious thinking behind the scenes about what Scottish independence could mean. In public the British government, hostile to Scottish nationalism, is keen to suggest there's no 'contingency planning' for any of this, as they don't want Scottish voters to consider full independence a viable option. But Rachel Lomax, former senior Treasury official and deputy governor of the Bank of England, would be surprised if planners in London aren't considering what independence could mean - including Scots creating their own currency.

LOMAX: Some of the most successful countries in the world are the same size as Scotland and have got their own currencies. The idea that it's absurdity, I think you know is not borne out by just looking around the world or looking at history. The really challenging thing is how you would manage the transition and whether it makes sense for Scots given their relationship with England and with their other neighbours. But you can be a very successful, rich, small country and you can be a very unsuccessful one. But getting from here to there is going to be tricky and sequencing things so that you do things in the right order, in a sufficiently gradualist and planned way and in a collaborative way, that's the heart of the matter.

BOWLBY: The priority for some in London is to deal with their deepest anxieties, insisting that the rest of the UK will accept no liability for what happens if an independent Scotland gets into financial trouble. The scenario they fear, suggests Charles Larkin, is that Scotland would spend and borrow more freely, assuming that London would bail it out.

LARKIN: From the point of view of the UK Treasury and from the Bank of England, the worst thing they could possibly imagine would be an Edinburgh government that has its own currency, is relatively easy with spending and basically starts issuing large amounts of Scottish government bonds based upon an implicit UK government guarantee. And that would be something which London would be very concerned

about. The only hope that they would have is that they would put in place a series of constraints and budgetary fiscal rules that would limit the capacity of Edinburgh to spend, and to borrow; and that Edinburgh, if it did issue its own bonds, would have explicit within it that there was no guarantee, implicit or otherwise, provided by the general UK taxpayer, that this would be entirely the Scottish citizens' problem.

SEGUE:

LOMAX: I think the last few years have been a learning experience for everyone. I think the blithe assumption that you just put arrangements in place and if they work for a few years that would be fine - that's out of the window. I think the costs of borrowing another country's credibility have been made very apparent if you look at the Irish experience, as well as the Greeks and the Icelandics and all the rest of it. So I think we've seen the pitfalls illustrated in a fairly dramatic fashion over the last few years.

BOWLBY: Rachel Lomax. So if Scots do say yes to independence, we could see a really tough negotiation with the rest of the UK over currency and political independence - just like the eurozone's now having as it tries to survive. The SNP's George Kerevan believes London will want to do a deal though to keep a common currency.

KEREVAN: London's taking a very strong view that you know it will all be doom and disaster, the end of the world, and we'll not agree to anything. If independence has been voted on in Scotland, I think very quickly the rest of the UK will come to realise that it's in its interest to maintain a common currency and a common currency zone of some kind and stable trading relationships. Why would you want a neighbour to the north that could suddenly have lower interest rates than you and see all the capital sucked out of the City of London? Would it not be sensible for a cooperation so that the foreign currency reserves that would accrue to an independent Scotland stayed within the Bank of England? There are all sorts of practical reasons why both sides of the border should cooperate and I think they'll see sense if it came to those negotiations.

BOWLBY: If a deal were done for the Scots to continue using sterling, the question of what happens in a crisis would be all-important. This is partly a matter of who stands behind the financial sector - would the Bank of England and taxpayers in the rest of the UK still be willing to bail out Scottish-based institutions, just as the Royal Bank of Scotland and HBOS were rescued a few years ago? The answer would seem to be no. But RBS is still majority owned by the British government. Working out its future, says Rachel Lomax, would be a key part of a new relationship between an independent Scotland and the rest of the UK.

LOMAX: The Royal Bank of Scotland is a special case for two reasons. I mean one is there's the possibility that it might be headquartered in Scotland, in which case the question's about who supervises it, who is the lender of last resort, what are the cross-border crisis management arrangements for handling any problems there because it would almost certainly have large amounts of business outside Scotland. So there's all those sorts of questions. You know at the moment the Royal Bank of

Scotland is a ward of the British state. *(laughing)* What happens to the shares in the Royal ... And it looks like being so for some time to come. So who owns it and what happens when it gets privatised? I think that's the first question.

BOWLBY: The cruel lesson of the last few years has been confidence - you want to know who ultimately stands behind your bank, or investment, or paper money. Economist and SNP member George Kerevan acknowledges the problem.

KEREVAN: I think the psychology of money is all-important. I mean you go into a shop and you give somebody a piece of paper and they give you a television set. I mean how stupid is that? Within the UK, we have never suffered a loss of confidence in currency within living memory, not since the 19th century and even then it's arguable; whereas you know France, Germany, mainstream countries of Europe, they've seen currencies change and disappear overnight. So it would come as a shock to people within the British Isles north and south of the border if they suddenly felt that currency wasn't what they thought it was. So the psychology is all-important.

BOWLBY: And we have had a run on a bank within very recent memory now.

KEREVAN: Indeed, and that really frightened people because you know I remember walking down to Northern Rock, to the local branch here in Edinburgh, and seeing the queues and talking to people. It came as a shock. So there is an onus on everybody to maintain that confidence.

BOWLBY: If the SNP has its way and Scots after independence continue to use their own banknotes within sterling, that might be the best recipe for maintaining confidence and stability. But others think the fact of political independence would have introduced a new element of doubt. And doubt is what financial crises feed on. So, ironically enough, it might be better for an independent Scotland to do away with that distinctive Scottish banknote design. Angus Armstrong of the National Institute of Economic and Social Research.

ARMSTRONG: Scottish pound notes, you're right, express a certain identity. But if an independent Scotland had an arrangement whereby the Bank of England continued to be the central bank for Scotland - then to remove any doubt at all in people's minds, it might be easier to use sterling pound coins rather than having Scottish notes.

BOWLBY: But you can imagine that would be pretty politically sensitive for an independent Scottish government to say oh these notes that you're used to in Scotland, sorry we're not using them anymore.

ARMSTRONG: It's one of the paradoxes of independence for countries today that in many ways some of the limitations that become put upon you by these international economic forces are that actually some of the freedoms that you currently enjoy may become unavailable to you.

VOX POP (Male Scottish Voter) *I don't think Scottish notes are really recognised abroad. So I think English notes are the main ones, so maybe we should keep it English.*

BOWLBY: Asking Scottish voters about their banknotes, I heard some sympathy for the view that it might be better to have the same banknotes as England and Wales. But all this talk of restrictive financial deals with London frustrates many supporters of Scottish independence. The Scottish Greens want Scotland to pursue a very different economic course from the rest of the UK, with as much control as possible. So the more financial and currency independence, the better. Patrick Harvie is the Scottish Green party co-convenor.

HARVIE: Over time, the economies of Scotland and the rest of the UK would be likely to diverge in terms of independence, and so over time it would become less and less viable to have political independence but a shared currency. Europe has a very divergent economy between the member states at the moment. Scotland and the rest of the UK don't have that level of divergence at the moment, but it would develop over time or it would be more likely to develop over time. And so that's another reason why a shared currency might be acceptable for a period of time, but the real requirement after that, once you've established political independence, would be to move on a fairly reasonable timescale towards full independence including an independent currency. I think a transition period is all very well, but it would come with strings attached and we should be setting our sights on a more ambitious form of independence.

BOWLBY: Or there might be another alternative for pro-independence Scots who fear staying too tightly in London's grip. What about joining a more stable euro? If the eurozone emerges from its crisis, it will require its members to sign up to tough policing of their economic policies. But perhaps rule by the eurozone might seem less irksome to nationalist Scots than what's seen as continued rule by the Bank of England and UK Treasury? Dr Angus Armstrong looks ahead.

ARMSTRONG: Today it would sound like madness to say you're joining the euro when it's peering over the abyss. However, in two years time, it could look a very different monetary arrangement. And if Scotland were to join the euro, first of all they'd be a member of the European monetary system, so they'd have a seat, a shared seat on the European Central Bank, and an equal vote - the same as all the other countries: one country, one vote. If they go ahead and have a European bank regulator, the problems of bank regulation are solved because they'd be under the European bank regulator. If they go ahead and have a European system of deposit insurance, then Scotland again would become part of that deposit insurance. Now there's some advantages. The disadvantage is of course the degree of integration between Scotland and the rest of the UK is greater than the integration between Scotland and the rest of Europe, so what you gain on the one hand you may lose on the other hand.

BOWLBY: Others hope that Scotland could take a much more independent minded course in finance and money. Scotland these days may have a reputation for a more left-wing approach to public spending. But free market enthusiasts swoon at the memory of so-called 'free banking' in Scotland going back to the eighteenth century. Banks issued paper money backed by their own assets, and co-operating banks agreed to exchange banknotes and honour each other's cash.

So it was local banks, rather than an external state authority, which decided whose money was valid, and how much could be issued. There was no central bank policing and guaranteeing the system until the British government took over in the nineteenth century. Philip Booth of the Cass Business School would love a revival.

BOOTH: Yes it would be very nice to see the Scottish traditions adopted again not just in Scottish politics in fact, but in English politics - Scottish traditions of a much smaller role for the state and a bigger role for the community; and in the financial sector, financial relationships which are much more regulated by trust and much less regulated by formal regulation from the state. But also a principle of sound money which doesn't necessarily need a central bank; that the commercial banks operate in such a way that they are prudent, financially responsible and maintain good, liquid, sound financial positions at all times and, therefore, don't need support from a central bank.

BOWLBY: If we're looking at this as a moment when we think more profoundly about the options available to a country in terms of currency, in terms of banking, we could think more radically than what appears to be the debate at the moment?

BOOTH: Oh we could certainly think more radically, yes. We could have a free banking system whereby banks were able to issue their own currencies; we could have a situation where parallel currencies were used alongside each other. There's no reason why the euro, the English pound and possibly even a new Scottish pound couldn't be used alongside each other - one currency being used perhaps more for business transactions and another currency being used for more day-to-day transactions.

BOWLBY: That would give London and the Bank of England food for thought. The Scottish nationalists know very well that financially nervous Scottish voters are hardly in the mood just now for too much novelty. But the SNP's George Kerevan intrigued me with his vision of a commercialised Scottish currency that might further change the way we think about money.

KEREVAN: Of course it's expensive to print the Scottish notes, so there's always a debate well why do it? And the banks - Bank of Scotland, Royal Bank - have continued to do it, Clydesdale, because it's good advertising. You know the actual currency you have in your pocket is not the state's currency, it's produced by a private company, which has always led me to suggest to the bankers up here in Scotland that they could defray some of their printing costs if they used the back of the pound just to sell advertising. You could put you know Coca-Cola or whatever you wanted on the back. I know that's lese majesty, so they always look at me askance when I suggest that, but you could do it.

BOWLBY: There's a thought: instead of today's limited varieties of local banknotes, you could find all kinds of colourful currencies in circulation in the new Scotland, maybe even Coca Cola fivers or Tesco tenners. For now, though, familiar and reliable money is what people want - with something like those giants and titans secure in the Bank of England as back-up for the cash in their wallets. But my time investigating Scotland's cash has taught me there are many

more ways of running a currency than we might assume.

LOMAX: I'm sure that there would be a lot of mental preparation even if the probability of the referendum going against independence was quite high.

BOWLBY: Rachel Lomax senses how carefully her former colleagues at the Bank of England and Treasury will be thinking all this through. What matters, she suggests, is to take the various scenarios seriously, not just pretend that nothing can ever upset the UK's long political and economic union.

LOMAX: I mean it would be irresponsible not to identify the issues, not to look round for useful evidence both in the literature and in history, and just get yourself in a position where you can deal with whatever decision you know the people reach.

BOWLBY: Money is shaped by history, culture and psychology, markets and the mood on the streets - not just policy-makers talking jargon in airless rooms. The UK's officials and politicians north and south are now grappling with all this, as well as the voters. Would currency, which can be so unifying or destabilising a force, restrain or accelerate Scottish independence? What's at stake for everyone in the UK as old monetary models are challenged and Scots prepare to vote after years of financial angst? Cash - who runs it, backs it, even designs it - has moved to the centre of the debate about Scotland's future.