

TRANSITION TO A SCOTTISH CURRENCY

In a follow-up to his paper on a Scottish Banking System (SIC Transition Paper No. 4), finance expert Peter Ryan presents a clear roadmap for the introduction of a Scottish currency in his paper Transition to a Scottish Currency (SIC Transition Paper No. 6). Peter argues that a future independent Scotland needs to adopt its own currency to avoid the risks of future economic shocks, such as a banking crisis or pandemic: "In order to reduce risk, Scotland should transition to an independent Scottish currency as soon as possible following the vote for independence".

He describes the types of money that make up a currency: cash, the money in your bank account and the money at the central bank. He argues that the introduction of the new Scottish currency can be de-risked by progressively introducing it over the transition period rather than trying to do everything on a given day.

Some key steps proposed in the paper are as follows:

- A Scottish Currency Bill should be drawn up prior to the independence referendum, which would establish a Scottish currency initially equivalent to the UK pound (£1 would equal 1 unit of the Scottish currency).
- Once a transition period to independence is in place new Scottish notes and coins will be introduced in stages rather than all on one day. This will allow people and businesses in Scotland to adjust to the new notes and coins as they are introduced.
- The Central Bank of Scotland should be set-up at the start of the transition period.
- The Central Bank of Scotland will issue notes and coins in the new currency and profits from this would go to the people of Scotland and not to the shareholders of UK banks. The three banks that currently issue Scottish Sterling notes (Clydesdale Bank, Bank of Scotland and Royal Bank of Scotland) will no longer be able to issue Scottish banknotes.
- Over the course of the transition period, commercial banks would apply for Scottish banking licenses and (if the license was granted) would begin converting existing bank accounts from Sterling to the new Scottish currency. By doing this over the course of the transition period we would avoid the delay of waiting for the slowest and reward those banks who make the investment in the new currency.
- At the end of a transition period the new Scottish currency would detach from Sterling and be a free-floating, independent currency in both physical and electronic forms.

To give the people of Scotland ownership of their own currency Peter proposes a competition on the currency's design that would start before the independence referendum with the results being announced immediately after a vote for independence. This would reduce delays in the production of Scottish notes and coins. The design competition for the new notes and coins, based on the theme "Scotland", would be as inclusive as possible. For example, the design of coins would be open to all children in Scotland aged 16 years and under and young people in Scotland aged 16-18 years; the designs of the notes would be open to all adults (aged 18+) in Scotland; and the design of the one "Scots" coin could be done by special groups (such as art therapy groups) and the design could change regularly after the initial introduction of the Scottish currency.

Some recent history is provided to illustrate that a currency transition can be carried out smoothly, for example the decimalisation of Sterling where the 50 pence coin was introduced in October 1969, 16 months before Sterling officially converted to a decimal currency in February 1971. Peter also reminds us that central banks periodically replace their notes with new designs to reduce the risk of fraud. This process normally takes around three years from the initial design through to production and distribution. This gives an indication of the realistic timeline needed to issue the new Scottish currency notes and coins. Peter estimates that, with designs agreed before independence, production of the first notes and coins could begin shortly after independence and be introduced over a two-year period.

Commercial banks operating as part of the new Scottish banking system will need to make deposits during the transition period into the Central Bank to allow them to issue loans, process payments between banks, provide mortgages, etc. As these deposits will come from foreign currency (Sterling for UK banks or Euro for European ones) they will be converted into the new Scottish currency issued by the Central Bank of Scotland. This would equate to deposits of around £25 billion and would provide approximately US\$33 billion of foreign currency reserves for an independent Scotland.

In addition to accepting and managing deposits, the Central Bank of Scotland would also make loans to financial institutions that have a license to operate in Scotland and manage the issuance of Scottish cash. For this the Central Bank will need an IT system, which would take an estimated two to three years to select, test and implement given the volumes required for Scottish Central Bank money.

When it comes to interest rates, Peter states that the only certainty is that with a new Scottish currency the interest rates will be set in Scotland, by the Central Bank of Scotland, and so will be appropriate for the Scottish economy. Having a Scottish currency could lead to cheaper borrowing for the Scottish Government and in turn cheaper interest rates for loans and mortgages in the new currency.

The introduction of a new Scottish currency will not affect peoples' pension rights. If retirees are receiving their pensions from the UK Government and choose to have their pensions paid into a Sterling account, they would receive the same amount as if they were living in the UK. If their UK pension is paid into a Scottish currency account, they will receive the Scottish currency equivalent of the Sterling amount.

According to Peter, "This is not the final word on the currency debate, but it should provide some clarity on how Scotland could transition from Sterling to a new Scottish currency, how long it would take and the benefits of doing so".

–ENDS–