Scottish Independence Convention (SIC)

Transition Paper No. 6

TRANSITION TO A SCOTTISH CURRENCY

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Introduction

There are differing opinions on the currency arrangements for an independent Scotland. The Sustainable Growth Commission[1] proposed in 2018 an extended use of Sterling following independence (sometimes referred to as "Sterlingisation"). Others, such as the Scottish Currency Group, are proposing a rapid introduction of a new Scottish currency.[2]

The Scottish Finance Minister, Kate Forbes, has said that under the current devolution settlement the Scottish Government does not have the economic levers (fiscal and monetary) to deal with the coronavirus and is left frustrated by the dithering of the United Kingdom (UK) Government.[3] Consequently, the Scottish Government has been reliant on the UK Government and support from the Bank of England, which has helped finance the UK furlough scheme through Quantitative Easing.[4] This was possible because the Bank of England, as the Central Bank of the UK, is the issuer of Sterling.

An independent Scotland would not have a full range of monetary policy levers if it does not have its own Scottish currency.

In the last 15 years there have been two significant global economic shocks – the financial crisis of 2007-2008 and the Covid-19 pandemic. On both occasions the UK has used Quantitative Easing to minimise the impact on the economy and to make it easier for the government to borrow money. If Scotland does not issue its own currency, it will be harder for an independent Scotland to manage these types of economic shock. For example, without a Scottish currency a new Central Bank of Scotland could not follow a policy of Quantitative Easing to finance its own furlough scheme.[5] Therefore, to reduce risk, Scotland should look to transition to an independent Scottish currency as soon as possible following the vote for independence.[6]

This paper describes how Scotland would manage the transition to a new Scottish currency. In doing so it will demonstrate how a new currency would meet the "financial requirements of Scottish residents and businesses"[7] in a way that minimises economic risk to provide a better future for the people of Scotland.

Transition Plan

Transition High Level Plan

The Sustainable Growth Commission recommends that "a decision to move to an independent Scottish currency should be based on a governance process and criteria set out clearly in advance of voters making a decision on independence".[8]

However, continuing to use Sterling until a time in the future when a group of politicians decide to introduce a new currency based on predefined tests, which may or may not be relevant, would increase the risks to the economy of an independent Scotland. It would also break the promise to the Scottish people of laying out the currency plans in advance of an independence referendum. It is important that there is a transition plan with realistic timescales to put before the people of Scotland. A published plan will reduce uncertainty in financial markets and allow Scottish businesses to prepare for the new currency. Financial markets hate uncertainty.

To avoid this uncertainty, a Scottish Currency Bill should be drawn up prior to the independence referendum to provide clarity to voters. The Currency Bill would establish an electronic Scottish currency, which initially would be equivalent to the UK pound (£1 would equal 1 unit of the Scottish currency) allowing the Scottish economy to continue to operate during the transition period.

Changing the currency will be a systemic change to the Scottish economy. It needs to be broken into smaller activities that will convert the currency of the economy over the course of the transition period. We should avoid having a "currency day" where everything converts at the same time as this type of overnight change is difficult for the most vulnerable members of society.

The easiest way to do this is to break down a currency into its components and look to independently transition from Sterling to a new Scottish currency. These components are discussed in detail below and include:

- Establishing a Scottish Central Bank and central bank money
- Introducing the notes and coins of a Scottish currency
- Establishing foreign currency reserves
- Setting-up a Scottish Banking system[9]

At the end of the transition period the new Scottish currency would detach from Sterling and be a free-floating, independent currency in both physical and electronic forms. At this point there would be an exchange rate between the currencies and it would no longer be possible to treat the two currencies as equivalent.

Technical Set-up of a Currency

Each currency has a currency code defined using the International Organisation for Standardisation (ISO) 4217.[10] The currency code for Sterling is GBP. This is made up of the two-character country code GB (referring to the UK), which is defined using ISO 3166,[11] and a character representing the currency (P for Pounds).

Not all "countries" on ISO 3166 country standard are sovereign independent states. For example, there are codes for Jersey (JE) and Gibraltar (GI). Jersey uses Sterling, but also issues its own coins and bank notes. Where banks need to distinguish between UK Sterling and Jersey Sterling the code JEP is used.

Shortly after a vote for independence Scotland can apply to the ISO to register a country code for Scotland.

Once published the new Scottish currency code would be communicated to financial institutions (including the Central Bank of Scotland) to allow them to set-up Scottish currency accounts and loans (as they are converted from Sterling) on their IT systems. In parallel, the Central Bank of Scotland would work with the ISO to have the new currency's code internationally recognised before the end of the transition period.

It is possible to link currency codes together, for example Gibraltar Pounds (ISO 4217 – GIP) is defined as equivalent to Sterling (ISO 4217 – GBP). So, the new Scottish currency can be linked to Sterling during the transition period while the two are equivalent currencies.

Money

Types of Money

Currency is the form of money in use in a country or region. In the UK economy today, there are three types of money:[12]

- Cash – banknotes and coins
- Central bank money – money deposited at the Bank of England by financial institutions
- Commercial bank money – electronic money that individuals, households and businesses have in their bank accounts or loans

Commercial banks, such as the Bank of Scotland, Royal Bank of Scotland (RBS) and Barclays, are regulated profit-making enterprises answerable to their shareholders. They are different from central banks, such as the Bank of England, Bank of Canada and Bank of Japan (or the future Central Bank of Scotland), which are government-owned and are instituted to maintain monetary stability in a national or regional economy.

We should plan to transition the different types of money separately.

Cash

While cash use is declining in relative terms (in 2017 debit cards overtook cash as the most widely used method of payment in the UK) there is still around £70 billion worth of cash in the UK economy (double the amount in 2007), representing around 3 percent of the money in the UK.[13]

There are two types of cash in use in Scotland:

- Bank of England cash – issued by the Bank of England
- Scottish bank notes – notes issued by RBS, Bank of Scotland and the Clydesdale Bank

Notes and coins issued by the Bank of England are central bank money backed by the Bank of England. They will continue to hold value while the Bank of England (and the UK as a state) continue to exist.

Scottish banknotes issued by the Scottish commercial banks are backed by deposits held at the Bank of England to an equal or greater value of the notes issued. This ensures that people with banknotes issued by Scottish banks receive the same level of protection to that of people who have Bank of England banknotes. The amount held by the Bank of England as backing for Scottish Bank notes, as of May 2020, was £4.87 billion.[14]

Central Bank Money

Banks and other financial institutions in an independent Scotland will need to hold money in accounts at the Central Bank of Scotland. Known as "Central Bank Money", these accounts are used to manage money in the banking system. For example, if a customer is using the UK Faster Payment service to pay money from an RBS account to a Lloyds Bank account, then the actual movement of money takes place as a movement of central bank money between the RBS and Lloyds settlement accounts held at the Bank of England.

Commercial Bank Money

Commercial bank money is electronic money that is recorded in the bank accounts and loans of individuals and businesses. It accounts for nearly 80 percent of the money in the UK economy.

Commercial banks create money by lending to individuals, households and businesses. To be allowed to create money a bank needs a banking license with the banking regulator (which will be the Central Bank of Scotland in an independent Scotland).

A bank is liable for the money held in an individual's bank account, though it is guaranteed by the government through a "deposit guarantee scheme" that protects individual and small business account holders up to £85,000. This is based on European Union (EU) legislation that provides a guarantee up to €100,000. It is assumed that the government of an independent Scotland would continue to guarantee Scottish bank accounts to an amount equivalent to the EU deposit guarantee scheme.

The conversion of loans and accounts to the new Scottish currency will need to be carried out by the commercial banks with the agreement of both participants to the legal agreement that the loan represents: the bank and the bank account holder.

Scottish Cash

Scottish Notes and Coins

Cash represents a small part of the economy so introducing new notes and coins is relatively low risk. However, introducing the new Scottish currency in physical form early in the transition process is of great symbolic value as it makes the new currency real.

The new Scottish currency would be a decimal "Scottish Pound" made up of 100 cents and notes and coins would be issued by the Central Bank of Scotland. Scottish notes and coins will have the same values as the existing Sterling notes and coins. This will simplify the introduction of the new notes and coins (for example a £1 coin will be replaced by a 1 "Scots" coin). It will also mean that shops will not need to change their tills as £1.23 can be held in the same compartments as 1.23 "Scottish Pounds".

To ensure a smooth introduction it will be prudent to issue the new notes and coins over the course of the transition period rather than introducing them all together at the same time. This will allow the Scottish public and businesses to slowly familiarise themselves with the new notes and coins. This was done when Sterling converted to a decimal currency – the 50 pence coin was introduced in October 1969,[16] 16 months before decimalisation came into effect in the UK in February 1971. During the transition period Scotland could use its own notes and coins while still using Sterling electronically, just as Jersey and Guernsey does.[17]

Central banks periodically replace their notes with new designs to reduce the risk of counterfeits. The process normally takes around three years from initial design through to production and distribution.[18] Therefore, a realistic timeline to issue all Scottish currency notes and coins would be two to three years.

Paying for Our New Cash

Central banks make a profit from issuing bank notes based on the difference between the cost of issuing the notes and the value received for the notes. This is known as seigniorage and is used to help pay for the running costs of many central banks around the world. In its 2020 Annual Report,[19] the Bank of England gave a figure of £555 million in net seigniorage income based on the issuance of £8.795 billion worth of bank notes[20] and a total value of £74 billion of notes in circulation.[21]

In the 2020 Scottish and Northern Ireland Banknote Issuance Report[22] the three authorised banks in Scotland (Clydesdale Bank, Bank of Scotland and RBS) had £4.49 billion worth of notes in circulation. So, in 2020, the value of Scottish bank notes in circulation was roughly 6 percent of the total for the UK.

It costs the Bank of England 8 pence to produce a £5 polymer note,[23] which indicates an estimated production cost of £18.7 million for a new set of Scottish bank notes.

The same profits cannot be made from lower denomination coins. However, based on the figures above, an investment of around £50 million would be required to create a new physical currency for Scotland with the Central Bank of Scotland in profit within two years.

ATM operators buy cash from the currency issuer. So, introducing Scottish notes early in the transition will help to fund the Central Bank of Scotland and allow it to invest in the IT systems it needs to manage the banking sector.

Sterling Notes Issued by Scottish Banks

The new Central Bank of Scotland will issue notes in the new currency and any profits from this would go to the people of Scotland and not to the shareholders of UK banks. Therefore, the three banks that issue Scottish Sterling notes will no longer be able to issue Scottish banknotes.

Currently the Clydesdale Bank, Bank of Scotland and RBS have deposits with the Bank of England of equivalent value to the notes that they have issued. Consequently, these banks will want to get back the notes they have issued to free up their deposits at the Bank of England.

A People's Currency

A design competition for the new Scottish notes and coins should be run based on the theme of "Scotland" and be as inclusive as possible. For example:

- Smaller denomination coins (1, 2 and 5 cents) designed by children in Scotland aged 16 years and under;
- The 20 and 50 cent coins designed by young people in Scotland aged 16-18;
- The designs of the notes would be open to all adults (aged 18+) in Scotland;
- The design of the one "Scots" coin would be done by special groups (such as art therapy groups) and the design could change regularly after the initial introduction of the Scottish currency.

This competition would start before the independence referendum and the results would be announced immediately after a vote for independence. It would give the people of Scotland ownership of their currency. It would also mean that the currency's design was decided at the start of the transition period to reduce delays in its production.

Scottish Central Bank Money

Any bank that wants a Scottish banking license will need to deposit money with the Central Bank of Scotland. This money can have different purposes, such as providing a capital reserve to stop the bank going bust in the event of a banking crisis or allowing the bank to move money in the Scottish payments system. These deposits will be held in the new Scottish currency to ensure the stability of the banking system.

UK banks applying for a Scottish banking license will need to withdraw money currently held at the Bank of England and deposit money with the Central Bank of Scotland (corresponding to accounts and loans moving from the UK to Scotland). Therefore, as part of the set-up of the Central Bank of Scotland an IT system would be established to receive these deposits and record the balances that commercial banks hold with the Central Bank of Scotland.

The money withdrawn from the Bank of England will be in Sterling and would be converted into the new Scottish currency before being deposited. This will involve a three-step process:

- Withdrawing Sterling from the Bank of England
- Converting the money into the Scottish currency
- Depositing the money with the Central Bank of Scotland

As the issuer of the Scottish currency, the Central Bank of Scotland would create the Scottish currency to be exchanged for the Sterling amount it receives. This will result in the Scottish Central Bank receiving pounds Sterling (or other currencies such as Euros if a European bank wanted a Scottish banking license or US Dollars if an American bank did). This foreign currency would be transferred to Scotland's foreign currency reserves.

A commercial bank wanting to take part in the new Scottish banking system (to issue loans, process payments between banks, provide mortgages) will need to make a deposit during the transition phase. These deposits will be large amounts. For example, RBS in its 2019 results[24] had a balance of just under £78 billion held at central banks and the Lloyds Banking Group had a balance of £49 billion held at central banks in its 2019 results.[25] The Bank of England, in its 2020 accounts, had £479 billion held on deposit from banks and other financial institutions.[26] Based on the existing banking system being replicated in an independent Scotland this would equate to around £25 billion being deposited at the Central Bank of Scotland to allow commercial banks to operate in Scotland and provide around US$33 billion of foreign currency reserves (foreign currency reserves are quoted in US Dollars by the International Monetary Fund).

In addition to accepting and managing deposits the Central Bank of Scotland will also make loans to financial institutions that have a license to operate in Scotland. As these loans will typically be in the form of Repurchase Agreements (Repos), lending cash in exchange for assets, such as sovereign bonds, the Central Bank will need an IT system to be able to manage these types of agreement.[27] There are several companies that supply these types of IT systems to central banks across the world and it would take an estimated two to three years to select, test and implement such a system given the volumes required for Scottish Central Bank money.

Commercial Bank Money

Bank Accounts

Most money held by people or businesses in Scotland is held electronically in their bank accounts. The liability for money held in these accounts is with the commercial bank and so converting the currency of these accounts will be managed by the commercial bank. While the process of converting bank accounts to the new Scottish currency is straight forward, there are several scenarios to consider. These include: 1) An account holder who does not want to convert their account to the Scottish currency; 2) a Scottish resident who has a bank account linked to an English or Welsh branch; or 3) where a bank decides not to take up a license to operate in Scotland and so does not offer Scottish currency accounts (like the UK banks which have chosen to withdraw from the EU following Brexit[28]).

However, while it cannot be assumed that all bank accounts will be converted to the new Scottish currency, it is also the case that banks will have legal obligations because of independence. For example, after independence Scottish and UK bank accounts will need to be separated because legally the nationality of a bank account must be identified to comply with anti-money laundering, taxation and other regulations.

It will be in the interest of the Scottish Government and the banking community to work together to progressively convert the bank accounts from Sterling to the new Scottish currency over the transition period. This could be done through an online or mobile app created by the Scottish Government in collaboration with the banks. This app would work as follows:

- The account holder will input their sort code (to identify the bank) and bank account number. Traditional sort codes are linked to a bank branch (for example, sort code 83-15-26 is the RBS branch in Ayr). However, internet bank accounts also “exist” in a data centre, such as the Monzo Bank sort code of 04-00-04, which is described as “Monzo Bank”.
- Once the bank has been identified, the app will send a message to request the bank to validate that the customer owns the bank account entered using the bank’s own security (Strong Customer Authentication[29] such as password, pin number or text to the customer’s mobile).
- Provided the customer passes the bank security, the customer would request a change of currency for their bank account from Sterling to the new Scottish currency. If the bank offers Scottish currency accounts the currency conversion would be processed by the customer’s bank.
- If the bank does not offer Scottish currency accounts, the customer will be redirected to a screen where they will have the option of opening a Scottish currency account with a bank that does offer this and switch to that bank. The existing Current Account Switching Service (CASS) could be used to switch to the new bank.

During the transition period, if a customer stays with their current bank the operation of the bank account would continue as before with the same mobile/online banking, debit card, and so on.

When the account is converted to the new Scottish currency the currency of any standing orders will be converted to the new currency since standing orders are linked to a bank account.

A direct debit, authorised by the account holder, represents a mandate to debit money from a bank account. This can be a regular fixed amount (to pay off a loan) or a variable amount (based on mobile phone or electricity usage). There will be several options to transition direct debits into the new Scottish currency:

- If the company receiving the direct debit (the electricity provider or local gym) chooses to accept payment in the new Scottish currency, then the direct debit would continue but would change currency. This switch will take place when the account holder changes the currency of their account.
- For companies that choose to continue offering services to Scottish customers but not to offer Scottish currency direct debits, the customer would need to switch supplier to pay in the Scottish currency (using a utility provider switching website) or continue paying in Sterling.
- For companies that choose to pull out of Scotland following independence the account holder would need to cancel the old direct debit and switch supplier. (It would make sense for the Scottish Government, as part of a general transition to independence support programme, to help people without access to the internet to switch utility provider.)

If a Scottish customer has a sort code linked to a branch outside Scotland, the account will be moved to a “Scottish” sort code following a request to convert the currency. This may mean a change of account number.

For customers who do not have access to online or mobile banking it would be possible to convert the currency in a bank branch with assistance from bank staff who would use the same software to facilitate the currency conversion. Any bank offering Scottish currency accounts would write to their customers with Scottish addresses to offer the currency conversion process free of charge. This letter could include a form to be returned by customers to request a change of currency for their account.

If a Scottish account holder wanted to keep their account in Sterling this would be possible provided the bank offered Sterling accounts to Scottish account holders. (This is comparable to Northern Ireland where many banks offer both Sterling and Euro accounts to individuals, households and businesses.) There could be an option on the app requesting to keep the Sterling account in addition to opening a new Scottish account. Many banks, such as RBS[30] and Starling Bank,[31] already offer multi-currency accounts so businesses could potentially transfer their banking to a bank that included the new Scottish currency in their multi-currency account offering.

The process of separating UK and Scottish bank accounts would begin as soon as a bank gained its Scottish banking license and this would continue throughout the transition period. Anyone with a Scottish bank account who did not want their account governed by Scottish banking law would need to move their account to their bank's UK branch.

Loans and Mortgages

Loans are “private contracts between individuals, households and businesses, and financial institutions”[32] and cannot be changed without the agreement of both the lender and borrower. If both the lender (the bank or credit union, for example) and the borrower (the individual or business) want to keep their loan under the existing terms, then they could do so; the loan would remain in Sterling and the interest rate and terms would remain unchanged.

Commercial banks prefer a borrower's income, bank account and any loans all to be in the same currency and they do not normally give foreign currency loans to individuals. If a borrower's income is in the new Scottish currency but they have a loan or mortgage in Sterling this would be classed as a foreign currency loan (because the income used for repayments and their debt are in different currencies[33]). Foreign currency loans are classified as high-risk investments because there is an increased risk of default due to exchange rate fluctuations. As a result, banks need to provision more capital for foreign currency loans to ensure they have enough money to continue operating if the loan is not repaid. The best action for the bank would be to convert the loan to the Scottish currency during the transition period at the same time as the account that is used to make the repayments is converted (requesting the conversion of loans taken out with a bank could be part of the account conversion app).

Irrespective of whether the currency of the loan or mortgage is changed there may be a change in the interest rate because of independence. The interest rate on a loan or mortgage is decided by many factors, such as the base rate of the central bank, the value of any collateral placed against a loan, the credit score of the borrower, purpose of the loan, the banking regulations of the country whose laws govern the loan, and so on. The Scottish Government should insist that commercial banks clearly communicate the interest rates for Scottish currency loans or mortgages and allow the borrowers to compare these rates with other interest rates from competitor financial institutions to enable Scottish borrowers to get the best deal available.

There is an assumption that if an independent Scotland continues to use Sterling, then individuals, households and businesses could continue to borrow on the same terms as the remainder of the UK (rUK).[34] However, borrowers in countries such as Kosovo or Montenegro that use the Euro, but are outside the Eurozone, have substantially higher interest rates compared to borrowers from Eurozone countries. Independence will change interest rates whether a loan or mortgage is in Sterling or the new Scottish currency. However, what the change will be (up or down) is subject to debate.

The Sustainable Growth Commission Report suggests that (post-independence) the costs to the Scottish Government, when borrowing in Sterling, will be 1 percent above those of the rUK Government.[35] Undoubtedly it is more expensive for a state to borrow in a currency that it does not issue because of the greater risk of default (for example Argentina's default on borrowing in US Dollars in 2001[36]).

If Scotland did have its own currency, it could influence the cost of borrowing by the Scottish Government through means such as Quantitative Easing where a central bank creates new currency and uses that money to purchase government debt held by financial institutions. These financial institutions then purchase new issues of government debt to replace the amount purchased by the central bank. This has the effect of creating extra demand for government debt and lowering the cost of borrowing for the government.

Financial institutions need to have capital reserves to allow them to lend. They hold government debt as part of their capital reserves as it provides a return on their capital (from interest payments for lending to the government) while at the same time being a safe investment. Lowering the cost of government borrowing impacts the cost of borrowing to individuals, households and businesses. 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 Scottish currency.

Ultimately there are too many variables to make an accurate prediction of interest rates in an independent Scotland. The lack of a Scottish credit history and the risk of a devaluation of the new currency could increase interest rates, whereas borrowing in its own currency and the stability of re-joining the EU could decrease interest rates. The only certainty is that with a 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.

Exchange Rates

Until the end of the transition period there will be a 1:1 rate between the Scottish currency and Sterling – after that time, the currency rate could change.

Sudden changes in the exchange rate between Sterling and the new Scottish currency would be enormously destabilising for UK commercial banks who have substantial numbers of Scottish customers. Similarly, businesses look for a stable exchange rate on contracts for goods moving between two countries with different currencies.

It will be in the interest of the Bank of England and the Central Bank of Scotland to minimise any disruption caused by exchange rate fluctuations.

To achieve this, exchange rates could be managed using a Foreign Exchange Swap between the two banks and there would be an agreement to intervene to dampen any sudden changes beyond an agreed tolerance. This would be used to stabilise the exchange rate of the Scottish currency against Sterling immediately after the end of the transition period.

To provide exchange rate certainty to businesses, banks would offer forward foreign exchange contracts to allow Scottish importers and exporters to plan for the end of transition (in other words "locking" the exchange rate to a pre-determined rate).

Using the Scottish Currency

Tax

During the transition period, when the new Scottish currency and Sterling will be equivalent, it will not make any difference which currency Scottish taxes or fines are paid in. However, in the Scottish currency legislation, the Scottish Government would mandate that all Scottish taxes and fines should be paid in the new Scottish currency after the end of the transition period.

Wages and Benefits

In the Scottish currency legislation, the Scottish Government would mandate that social security payments would be paid in the new Scottish currency before the end of the transition period. The legislation would also include a right for anyone employed in Scotland to be paid in the new Scottish currency. This right would not stop employees continuing to be paid in Sterling if they and their employer chose this option.

Shop Prices

During the transition period the new Scottish currency and Sterling would be equivalent so shop prices would not change as the Scottish currency is introduced. This will avoid the creeping inflation that took place during some other currency conversions (such as UK decimalisation in 1971). It will also make the conversion easier to understand as an item costing £1.00 will be priced at 1.00 in the new Scottish currency. This will ensure that Scottish currency prices are easily understandable (they will be the same as the old Sterling prices) and costs to shopkeepers are reduced (they do not need to re-price all their stock).

Websites

As with shop prices, on the final day of the transition period on-line shopping prices will be the same in Sterling and the Scottish currency. However, any websites that display prices would have to indicate the currency of the prices. Websites that display prices in different currencies (Sterling, Euro, US Dollars) will need to add the Scottish currency to the list along with a corresponding Scottish currency price. Websites that only display a price in Sterling will need to be amended to explicitly state that prices are in the Scottish currency or show prices in both Sterling and the new Scottish currency.

Prices (and stock) change over time so most businesses would make these amendments during normal regular updates (no business keeps its prices and stock the same forever). However, given that many different factors could trigger the need for changes (taxation rates, specific legal wording, data protection rules) then changing a business website following independence would not be dependent on the change of currency.

Business Contracts

Existing business contracts priced in Sterling would continue to be valid in Sterling unless they were renegotiated. It would make sense for a contract between two Scottish companies to be changed to the new Scottish currency. However, if a contract was between a UK company and a Scottish company the UK company may want the contract to continue in Sterling.

A lot of trade with companies outside the UK is priced in US Dollars or sometimes Euros (if both parties are in Europe) and these contracts would remain in these currencies following the introduction of the Scottish currency.

UK Pensions

If a person has paid enough UK National Insurance contributions, they will qualify for a UK state pension. It should be possible for the retiree to choose which country their pension is paid in. If they live outside the UK, then the UK Government pays the UK state pension in the local currency.[37] During the transition period there will be no change in the pension amount since Sterling would be treated as the local currency in Scotland. After transition, if the retiree was receiving their pension from the UK Government and chose to have their pension 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, in which case the amount could change because of exchange rate fluctuations.

There could be an agreement between the rUK and Scotland for the Scottish Government to pay for the pensions in Scotland. In this case the longer-term impact will depend on the social security settlement between the two countries. Any pension received from the Scottish Government would be paid in the new Scottish currency.

Redenomination of Government Debt

In the first Scottish Independence Referendum in September 2014 the UK Government made a commitment to honour all UK debt.[38] However, the Sustainable Growth Commission made the point that Scotland should make "Annual Solidarity Payments"[39] towards the UK debt as a way of building up a record of debt repayment. UK sovereign debt held at the time of independence would be denominated in Sterling. The Scottish Government could pay the Sterling amount from Sterling tax receipts as proposed by the Sustainable Growth Commission. However, if there were insufficient tax receipts, this could quickly deplete their Sterling reserves and exposes the Scottish Government to foreign currency debt risk.

The Sustainable Growth Commission, while considering the rights of the UK Government and financial institutions, ignored the rights of UK debt holders (many of whom would be Scottish residents). Once an independent Scotland introduced its own currency any Scottish resident holding UK debt ("government bonds") may want to have their savings, and be paid interest on their savings, in the new Scottish currency rather than Sterling (likewise Scottish personal pension holders). It is wrong to penalise ordinary savers by forcing them to accept an exchange rate risk on their savings. One solution to this is to allow individuals who hold UK sovereign debt (either individually or through a pension) to request that this debt be redenominated into the Scottish currency and any interest or capital repayments be made in the Scottish currency. This would allow the Scottish Government to build up a record of debt repayment without exposing itself to foreign currency debt risk.

The actual settlement of sovereign debt would be subject to negotiation between the rUK and Scottish governments, but the Scottish Government should try to avoid being responsible for repaying debt in Sterling as this would expose the Scottish economy to the possibility of foreign currency default.

Conclusion

The introduction of a new currency is a technical operation. The steps are known, well documented and since 1990 most European countries have changed their currency. German, French and Italian banks all converted their banking systems to the Euro within a three-year period. So it is not unrealistic to predict that technically it would take Scotland around three years to install a banking IT system (as required by the Central Bank of Scotland) and introduce a new physical currency.

The financial markets hate uncertainty (as has been clearly demonstrated by the Brexit saga). For Scotland to thrive, Scottish businesses need the clarity that comes from a firm decision on the introduction of a new Scottish currency and an indicative timeline for its introduction. This will allow businesses to make their own plans and allow them to make a success of the opportunities that come with Scottish independence.

The unknown factors are around the political decisions and how long any independence negotiations would take.

The decision on Scottish independence is a decision for the people of Scotland and when making that decision it should be made clear which currency an independent Scotland would use. If the people of Scotland vote for an independent Scotland with its own currency, then that democratic mandate should be respected.

The Covid-19 pandemic and its economic impact has highlighted the risks associated with the continued use of Sterling by an independent Scotland. But for the people of Scotland to make an informed decision on whether to keep Sterling or opt for a new Scottish currency come independence they need clear information from the people who are advocating the introduction of a Scottish currency. This document 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.

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8 https://www.sustainablegrowthcommission.scot/report Section C1 (“Currency Recommendation”)

9 This is described in an accompanying document on the set-up of the Scottish Banking system following independence

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