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The Economics of Constitutional Change

An analysis of the dominant economic factors for the scenario of Scottish independence

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On 18 September 2014, the Scottish electorate was asked whether Scotland should become an independent country. Although independence was turned down, the debate has opened up various questions, many of economic nature. This thesis discusses the economics of constitutional change with reference to the case of Scottish independence. It contributes to the academic debate by identifying the factors most critical to the success of an independent Scottish state. At first, the framework of constitutional change and plausible constitutional options for Scotland are outlined. Then, macro- and microeconomic topics relevant to independence are analysed. Detailed attention is paid to the question of currency choice and monetary policy. Other predominant issues under discussion are fiscal policy, state finances and the general impact greater autonomy might have on economic growth. Moreover, a brief case study of the oil and gas industry is utilised as an example of Scotland’s key industries and their impact on the economics of independence. Building on this in-depth literature analysis, the Critical Success Factor model is applied to the scenario of Scotland becoming independent from the United Kingdom. The study results in identifying currency and monetary policy, the oil and gas industry, population, and exploitation of opportunities opened up by independence as the most critical success factors, if success is measured as economic performance relative to the rest of the United Kingdom.

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1 Introduction

Scotland has a long and rich history both as an independent country and, for over 300 years now, as part of the United Kingdom (UK). It belongs to what was once one of the greatest empires and still is among the political and economic leaders of the world. Scotland itself has been multiple times the centre of the world’s attention and nest for some of the most outstanding inventions and brightest people. Autumn 2014 marked yet again another crossroad of the Scottish journey when the first referendum in modern times on total Scottish independence was held on 18 September. Although the electorate eventually decided that Scotland stays in the union, the independence debate has opened up various questions and sparked interesting discussions.

Primarily, any question of independence is, by nature, political; who should hold the power and would act in the best interest of a given region? In the Scottish case, the economic aspects of the decision played a pivotal role. The uncertainty and risk of independence for the Scottish economy was in fact one of the main reasons for the No-vote (Lord Ashcroft Polls, 2014: 17). Both political campaigns, Yes Scotland (pro independence) and Better Together (pro union), stressed the economic vision of their respective agenda and were joined by a great number of, presumingly more neutral, (academic) commentators.

While it is generally acknowledged that Scotland could be a successful independent country there is controversy about how to best achieve and secure this. One of the main arguments is about the currency of a Scottish state. The pro independence campaign made the case that it would be in the best interest for both Scotland and the rest of the United Kingdom (RUK) to form a currency union. This was, however, turned down by Westminster politicians. The other currency options for an independent Scotland generally are creating its own currency, trying to join the Eurozone or keeping the pound without the approval of the RUK. Each of the options has its advocates and set of consequences.

1 “Westminster” refers to the area of London where the British parliament is located and commonly used as a synonym for the UK parliament and government.
The outcome of the referendum has put an abrupt end to the dreams of Scottish independence for the nearby future. Sadly, this is also true for much of the discussion about the economics of constitutional change regarding the Scottish case; many questions and concerns were left unanswered. This thesis attempts to revisit the most important issues and will this way help an informed debate in the future. Furthermore, the independence topic was dominated by mass media looking at some chosen aspects. Preliminary research for this thesis has found that the debate has left loose ends behind and lacked an overall, comprehensive approach to the economics of Scottish independence. Andrew Goudie (2013) has identified the same problem. In the book “Scotland’s Future: The Economics of Constitutional Change” he has gathered and edited contributions of renowned experts on various topics regarding Scotland’s independence.

This thesis follows this path and tries to address the question of which economic factors are the most relevant for the Scottish independence case. Firstly, the economic framework underlying constitutional change is discussed and aspects of it, such as the interrelation between different economic themes, are analysed. This way the generally important topics for constitutional change are identified. These are discussed in detail and analysed with reference to Scotland in the subsequent chapters. The final part builds on this foundation and applies the Critical Success Factor tool to this scenario in order to identify the elements that should be prioritised and addressed properly to ensure long-term success of independent Scotland. Before that the methodology used for the research is explained. Also a chapter outlining the context of Scotland’s independence movement is included.
2 Methodology

The currency of the events underlying the research idea lead to the privilege of having a large quantity of up-to-date literature available. The thesis takes advantage of this situation and is founded mainly on secondary sources coming from a range of contributors, including academic journals, informed commentary, government reports, publications from various research institutions and centres, newspapers, periodicals and textbooks. At a later stage, quantitative data is used where applicable.

This approach ensures that the analytical framework is built upon a thorough understanding of the theories and policies relevant to the economics of constitutional change. Specific characteristics of the Scottish economy are then discussed on this basis. The link is made with regards to various economic topics, for example macroeconomic aspects and general growth prospects. While the whole thesis is written as one comprehensive analysis, later chapters are devoted to the application of specific tools, for example the Critical Success Factor Analysis. This contributes to the development of a specific verdict.

By nature the research carried out has certain limitations; the analysis is based on and features some assumptions. These are, however, widely accepted and made to the best knowledge of the author. Moreover, the choice of taking a universal approach to the topic means that certain themes of Scottish independence are only covered briefly. This does, however, not contradict the aim of the thesis: to identify and analyse the most essential factors of the economics of the Scottish independence scenario.
3 Path to the Independence Referendum

Before discussing the economic themes of Scottish independence in detail, this chapter aims at explaining the framework and history for the scenario of independence for Scotland and briefly summarising the outcome of the referendum of September 2014.

Scotland has a long tradition of independence thoughts and movements, typically with the Scottish National Party (SNP) in the vanguard. Already in 1967 Winnie Ewing won the first ever seat in the Westminster parliament for the SNP, which at the time was sensational and paved the way for the SNP (The Scotsman, 2007). In 1979, the first referendum on devolution was held. Even though a tiny majority of 52% voted in favour of devolution, a previously set quota that 40% of total electorate should vote in favour (the Cunningham Amendment to the Scotland Act 1978) was not reached: the turnout was 63.6%, meaning 32.9% of total electorate voted "Yes" (Scottish Political Archive, 2006). Consequently, the status quo continued. It took until September 1997 before Scottish people were asked again. This time needed to decide whether there should be a Scottish parliament and if a Scottish parliament should have tax-varying powers. Both proposals were accepted by the majority and the UK parliament passed the Scotland Act 1998 shortly after. The act established a Scottish parliament (first election held on 6 May 1999) and an own Scottish government lead by the First Minister (Scotland Act 1998). It defines the legislative powers of the parliament by stating which powers remain with the central UK parliament (reserved powers). So everything else that is not explicitly stated as reserved, is within the legislative competence of the Scottish parliament (devolved powers). The reserved powers, as detailed in Schedule 5 of the act (Scotland Act 1998: 82-100), mainly concern the constitution, foreign affairs, public service, defence, finance and economy, home affairs, trade and industry, energy, transport, social security, employment, media and culture, and some areas of health and medicine. Consequently, the following aspects are considered devolved: education, housing, judiciary and police, agriculture, forestry and fishery, environmental matters, heritage, sports and tourism, some aspects of economic development, and some of healthcare.
The funding for Scotland continued to come from a block grant from the UK using the Barnett Formula to calculate annual adjustments. So the money for activities of the Scottish parliament did not come from Scottish taxes, nor was it in any way linked to the performance of Scotland’s economy (Gallent, 2000). As mentioned above, the referendum covered the question whether the Scottish parliament should have the power to adjust taxes but taxation, as a matter regarding finance and economy, remained reserved. The one exception is income tax; the Scottish government was given the right to adjust the basic rate of UK income tax by up to three percent (Scotland Act 1998: 32). This power has, however, never been used.

So this marked a first step of autonomy for Scotland, giving it the opportunity to pursue certain policy entirely focused on Scotland. Higher education is, for example, free of charge in Scotland while there are tuition fees in the RUK and a ban on smoking in public places was first introduced in Scotland (BBC, 2006). But still the vast majority of decisions, especially regarding the economy, were taken at Westminster and Scotland did not benefit more from its own economic success than before.

During the next years, some minor amendments to the act were implemented. In 2007, the SNP campaigned for the upcoming Scottish parliament elections with the promise to hold a referendum on independence (BBC, 2007) and emerged as the winning party. They were, however, not able to fulfil their promise, as they did not have a majority in parliament (The Scotsman, 2014) and all other parties were opposed to the idea of holding an independence referendum. The next election in 2011 changed this picture: The SNP won the majority of the seats (BBC, 2011) and were now able to pursue this goal without needing support of any other party. An important step was taken in October 2012 when the so-called Edinburgh Agreement was signed by the two governments agreeing on the general terms and conditions of the referendum (Scottish Government, 2012a). In early 2013, the exact wording of the question was agreed upon (Carrell, 2013) and in March the date for the referendum was set to 18 September 2014.

In the meantime, the Scotland Act 2012 was passed devolving considerably more powers to the Scottish parliament, namely regarding taxation (adjusting income tax by up to ten percent and additional minor tax powers, such as tax on land transactions), the ability to borrow money (up to £2.2 billion) and other, non-economic aspects, including
guaranteed Scottish representation in the BBC or powers related to driving and drug use (Scotland Act 2012). The act will, however, come only into force in 2016. This is particularly curious because two days before the referendum, the leaders of the three main UK parties, David Cameron, Ed Miliband and Nick Clegg published a joint statement promising to transfer more powers to Holyrood\(^2\). They “guaranteed” extensive new powers for the Scottish parliament and that it would be a permanent part of the British constitution (Clegg, 2014). They furthermore promised to keep the Barnett formula as a tool for allocating the Scottish budget, give Scotland power to raise its own funds and make the final decision on spending on public services in Scotland. They also addressed the issue of the National Health Service by promising that Scottish people will decide whether or not to keep it in public.

To what extent the vow contributed to the outcome of the referendum may be the topic of another debate. Nonetheless independence was turned down on 18 September 2014 with a majority of 55.3 percent voting against and a turnout of 84.6 percent. In only four out of 32 areas did the majority vote “Yes”. (BBC, 2014) For the case that the outcome would have been in favour of independence, the proposed date of independence was 24 March 2016, allowing about 18 months for negotiations and procedures to take place (McKenna, 2013).

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\(^2\) The term “Holyrood” is used as a synonym for the Scottish parliament and government. It is the name of the area where the Scottish parliament building is located.
4 Economics of Constitutional Change

The objective of this chapter is to set the constitutional context for the economic debate. It briefly explains constitutional models that have been proposed in Scotland and then identifies the predominant factors of the economics of constitutional change with reference to the Scottish case and illustrates their interdependencies.

4.1 Constitutional Models

Constitutional change does not necessarily mean that, for example, a region without any, or very limited, autonomy becomes an independent country with full powers from one day to another. The way to independence usually consists of many small steps of gaining more autonomy and often takes decades and various attempts. As detailed above, also Scotland at first reached for some powers and limited autonomy, and this was achieved only in the late 1990’s (The Scotsman, 2014).

Consequently, independence was not the only option to continue Scotland’s strive for greater autonomy thereafter. Indeed, various models with different levels of self-determination covering the entire range from a renunciation of devolution to full sovereignty were discussed. Two of the more popular ones, besides the status quo and independence, were the so-called Devo Plus and Devo Max models. The former, supported by a cross-party initiative of liberal democrats, labour and before the referendum conservatives (Carrel, 2012), proposes a model of devolution, which would give Scotland control of many aspects of welfare (leaving namely state pension and sickness payment reserved) and increase tax raising powers (Scotland would control up to approximately two-thirds of taxes including corporate and income tax). Scotland would also be rewarded with a geographical share of North Sea oil revenues. Devo plus aims at making Scotland more accountable. It would have to raise the money it wants to spend (Gordon, 2014). The latter, the Devo Max model, provides even more autonomy for Scotland. It adds the power over national insurance, state pension and raising the vast majority of tax. There are, however, several variations to this model, for example regarding the control over Value Added Tax. Nevertheless, Scotland would then have
to pay the central UK administration for shared services. These would mainly be defence and foreign affairs. It is also suggested that matters such as financial, employment and competition regulation would remain reserved, meaning that the central UK government would still control them. The two concepts should, however, not be seen as definite, and, especially Devo Max has been criticised for lacking clarity and precise information (Buchanan, 2012).

Taking Devo Plus and Devo Max as two examples of more profound versions of devolution, the most important and thus distinctive factor obviously is the degree of political independence within the union with the RUK. Likewise there are variations of the constitutional model of independence, although the theoretically unlimited degree of political independence is, by design, the common pillar. To what extent a state decides to exercise its independence may vary. While it is hardly argued that countries such as France or Germany are fully independent, they have decided to join the European Union (EU). Even more, they have become members of the European Monetary Union, adopted the Euro as their currency and consequently handed over substantial powers to EU institutions, in particular regarding monetary policy (Scheller, 2006), which other independent countries still hold. Goudie (2013) also uses the question of currency and monetary policy to distinguish different models of independence. He identifies fives sets of plausible constitutional models for Scotland:

- The devolution settlement of the Scotland Act 2012
- The Devo Plus proposal
- The Devo Max proposal
- Independence within a monetary union
- Independence with own currency

The option of independence within a monetary union might be even further divided. The Yes-campaign has proposed that Scotland would continue using the pound, preferably as part of a currency union with the RUK (Scottish Government, 2013a: 3). However, UK politicians, for example George Osborne (2014), made it clear that they did not want Scotland to be part of the UK monetary union. Although this may be mainly seen as an attempt to scare voters not to vote for independence (Watt, 2014), the model of Scotland using the sterling without formal approval of the RUK, and the

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3 This is leaving aside (conspiracy) theories for example regarding German sovereignty (Deutsche Welle, 2013).
consequences, deserve consideration. Figure 1 below illustrates the structure of possible and plausible constitutional arrangements.

![Diagram of Constitutional Arrangements](image)

Figure 1. Constitutional Arrangements, based on Goudie (2013: 21), edited

All of the proposed models and their economic implications are worth discussing. After the No-vote this is particularly true for the Devo Plus and Devo Max model, as a new wave of devolution was promised prior to the referendum for the case of a No-vote (Clegg, 2014). For the purpose of this thesis, the focus hereafter will be primarily on the scenario of independence and its different types.

4.2 Economic Factors and Interdependencies

While the choice of the model is necessarily the predominant one when considering constitutional change, it is essential to understand the interdependence of the subsequent decisions regarding economic policy. It is therefore crucial to establish a framework of the most important decisions following independence and look at their respective hierarchy. This is attempted below.

As shown in Figure 1 and briefly explained above, one choice with an immense impact on many other topics in an independent Scotland is the pick of a currency. The currency, or rather its structure, sharing with other countries or having an own one, is directly linked to monetary policy. The different possibilities, having an own currency, joining the euro, keeping the pound as part of a monetary union, or keeping the pound as a
unilateral decision, would lead to distinct monetary policy options for Scotland. Establishing a new Scottish currency, for example, would provide Scotland with direct clarity and power, as the outcome would not depend on negotiations with external partners. (Goudie, 2013) While in theory this would offer a great deal of flexibility, the actual policy options available might be limited. It seems likely that the new currency would be relatively volatile (Her Majesty (HM) Treasury, 2013: 92) if not pegged to a strong and established currency, such as the UK pound. Doing so is, again, a limitation of flexibility and consequently reduces decision-making power. Moreover, keeping and defending a peg might prove to be difficult. In order to do so, it can be assumed that Scotland would need to run consecutive fiscal surpluses, which would logically lead to stricter fiscal policy, directly impacting spending and taxation decisions (Kay, 2013). Already this simplified example illustrates the great degree of interdependence of economic aspects and the primary importance of the currency question, which will be discussed in greater detail in chapter 5.1, as the first of the macroeconomic themes. Also the fiscal policy framework and its implications for the wellbeing of independent Scotland’s economy are considered (chapter 5.2). The financials of a new Scottish state is another key debate, among both politicians and academics, in particular because reliable data is scarce (Goudie, 2013). A core element is the inheritance of national debt; its allocation directly impacts Scotland’s fiscal balance and has, again, consequences for further policy actions (Goodheart, 2013).

Next to the macroeconomic discussion the focus should also be on what independence would mean in microeconomic terms. After taking a look at how greater autonomy would, or potentially could, impact economic growth (chapter 6.1), microeconomic aspects that are vital to Scotland’s success are closely examined. This includes higher education and research and development, energy and, of course, the story of North Sea oil and gas. The latter is of particular interest because oil revenues have been a central argument of the Yes-campaign (for example, Scottish Government, 2013b) and it is a sector on which constitutional change, in the forms proposed, has relatively little impact.
5 Macroeconomic Themes

Macroeconomic topics are extremely important for the prospect of any economy. If Scotland were to become independent, a framework would have to be quickly developed. As discussed already, the currency choice appears to be a reasonable starting point and is hence analysed below. Afterwards also fiscal policy and Scotland’s financial situation and structure are evaluated.

5.1 Currency and Monetary Policy

The options that an independent Scotland could consider are, as mentioned before:

- Adopting the euro
- Continuing to use the pound within a monetary union with the RUK
- Continuing to use the pound without monetary union membership
- Introducing an own currency, pegged or floating

All of the scenarios will now be discussed in more detail.

5.1.1 The Euro

One of the main objectives of the Yes-campaign was that Scotland would be a member of the EU (Scottish Government, 2013c). It seems unlikely that Scotland would inherit the UK’s opt-out from the Eurozone⁴ (Curtis, 2014). Hence, Scotland would be expected to adopt the euro eventually. In order to qualify formally, a country needs to fulfil the convergence criteria (also known as Maastricht criteria), which are:

- Inflation must not be more than 1.5 percent above the average inflation rate of the three EU member states with the lowest rate for the previous year,
- National budget deficit must be no more than three percent of gross domestic product (GDP),
- National public debt must not exceed 60 percent of GDP,

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⁴ Unfortunately, an in-depth analysis on EU and Eurozone membership of newly founded independent Scotland is beyond the scope of this thesis. A detailed but very accessible discussion of the arguments is provided by Polly Curtis (2013).
• Long-term interest rates must not be more than two percent higher than the average rate of the three EU members with the lowest inflation rate for the previous year,
• The national currency should enter the Exchange Rate Mechanism two years prior to the introduction of the euro in that country (Consolidated Version of the Treaty on the Functioning of the European Union: art. 140)

Although the criteria have been undermined by various countries, especially early on by France and Germany, it is to be expected that Scotland would have to follow them. There might arguably be room for negotiation on the last criterion. There has, however, never been a similar case (Kay, 2013).

Adopting, or even planning to adopt, the euro would consequently mean a direct impact on fiscal policy. While the exact share of the debt Scotland would inherit from the UK is not entirely clear (see chapter 5.3 below), future spending and taxation promises would have to be tested against the aforementioned criteria. Even more importantly, the European Central Bank (ECB) is responsible for monetary policy (Scheller, 2006), for instance, determining all levels of interest rates, and thus Scotland would have to hand this power over. According to Kay’s analysis (2013), there would then be a premium or discount on Scottish rates reflecting its (perceived) creditworthiness relative to the other member states. In return, Scotland would be granted representation at the governing council of the ECB and could in this way influence decision-making. With around 20 Eurozone members, the influence of one, relatively small, country such as Scotland would be limited. Scotland would also be expected to participate in already existing arrangements, for example the stability mechanism.

While joining the euro is considerably a feasible option for an independent Scotland in the long-run, this cannot be said for the time being. It is generally agreed that the Eurozone members have not found solutions for many of their issues. Some even argue that the euro does more harm than good; Elliot (2014) provides an overview of this debate. Kay (2013) also argues that Scottish membership of the Eurozone does neither make sense for Scotland nor the current members, as long as the RUK does not use the euro.
5.1.2 Monetary Union with RUK

This option would be the closest to the status quo and come with little change (Scottish Government, 2013a). The Bank of England would continue in its role as a central bank, also for independent Scottish territory. Ideally, ownership and governance would be shared between the two countries while the bank itself would remain independent from political swings and monetary policy would be set looking at the needs of the union as a whole. This is at least the desired scenario of the Scottish government, as stated, for example, by John Swinney (2012). The Fiscal Commission Working Group (Fiscal Commission Working Group, 2013a: ch.2.5) furthermore claims that it would be in the best interest of the RUK, too, to create a currency union with a new Scottish state. They counter concerns that Scotland would be too weak to participate in this system by pointing at the relative wellbeing of the economy of Scotland, especially compared to other parts of the UK.

Nonetheless, there are significant other issues. Even though, there would not be a fiscal union, both countries would have to come to an agreement on fiscal conditions. The tightening or loosing of the fiscal policy in one country would directly impact the other. In particular with the euro crisis still going on, it is highly unlikely that the RUK would not want insights on Scottish finances, and desire significant control over them. There would possibly be a cap on Scottish deficits and debt levels (Kay, 2013). Yet, the Eurozone experience with the Maastricht criteria shows how difficult it might be to enforce those agreements. While the RUK might at least have the threat of being much bigger, Scotland could hardly exert any control over the degree of fiscal prudence of the RUK, even in the unlikely case that the RUK would grant Scotland this power in theory. Similarly it can be assumed that monetary policy for the currency union would be much more focused on favouring the large part of the union, the RUK.

This arrangement certainly has its benefits, such as the avoidance of placing extra barriers on the trade between the two countries. Also, while this scenario seems to require relatively little change, it does make Scotland more independent in theory. In practise, Scotland might end up being dependent on and dominated by the RUK, with regards to both monetary, and to a certain degree, fiscal policy (Kay, 2013). After all, the option of forming a currency union with Scotland has been rejected by ruling UK politicians (for example, Osborne (2014)).
5.1.3 Unilateral Use of Sterling

If Scotland does not reach agreement with the RUK to form a currency union but still wishes to keep the pound, it can, of course, do so unilaterally through so-called dollarisation. Even though this action is usually not appreciated by the institution issuing the currency, there is hardly anything it can do about it and several examples exist, one of the most prominent ones being Ecuador’s adoption of the US dollar in 2000 (World Factbook: Ecuador). Other examples include smaller, and often less prosperous countries as for example European microstates (Andorra, Monaco) or Montenegro (European Commission, 2014) For these small countries it makes sense in order to avoid the immense costs and complexity associated with the apparatus needed for an own currency and a central bank. That there is, according to Kay (2013), “no modern analogue for the adoption of such policy by a country of the size and economic sophistication of Scotland” indicates the significance of the disadvantages associated with dollarization. First of all, a country following this system has neither influence on monetary policy nor access to a central bank, and no analogue institution on its own. It does, furthermore, not derive any benefits of seigniorage. This is the profit gained from printing notes and minting coins that usually the central bank of a country collects (Feige, 2013). Also the reserve deposits commercial banks have to make at the central banks yield a profit, which countries unilaterally using another country’s currency do not receive. Moreover, such a country will have to import great amounts of the other currency so its people would be able to use it and its banking system enabled to fully function. In order to achieve this, it has to run significant trade surpluses or borrow from the country with that currency. Either way requires implicit monetary and fiscal discipline (Kay, 2013). This is also the downside for Scotland. It would be able to keep the pound but at the cost of a great deal of its independence.

5.1.4 The Scottish Pound

If none of the options above seems desirable or possible, Scotland could decide to introduce its own, new currency. This is the most independent choice. Scotland could have its own central bank, control the issuance of the money and adopt policies as it wishes (Kay, 2013). The dominant decision would then be whether a Scottish currency should be freely floating or pegged. Pegging a currency means fixing its exchange rate
to a reference currency (or a basket of currencies). For Scotland, the most reasonable scenario might be a peg to the pound Sterling due to the high degree of integration between the economies and their obvious proximity.

Fixing the exchange rate has significant advantages, in particular for businesses operating in both countries, as it reduces exchange rate risks to a minimum. Also a fixed system decreases volatility and fluctuation of prices. Moreover, a country that is able to maintain a peg to a well-performing economy, earns credibility (Kay, 2013). This, however, points out one of the greatest disadvantages. Once a country decides to peg its currency to another, it must be able to hold and defend the peg. Right from the beginning the country is required to have strong reserves of both currencies in order to keep the fixed rate (Kay, 2013). Scotland would likely start independence with a share of UK foreign exchange reserves of around £10 billion, based on a population share (Armstrong, 2013), which in modern world’s financial terms is minimal. According to the governor of the Bank of England, Mark Carney, countries using a foreign currency peg should have at least 25 percent of their GDP as foreign exchange reserves (Cadman and O’Connor, 2014). In the same article it is also noted that Hong Kong, a country with a large financial sector, has piled up reserves of 110 percent of its GDP. It is thus estimated that Scotland would need between £32 and £163 billion in reserves. This illustrates that a country pegging its currency cannot use monetary and fiscal policy entirely freely and could, in contrast, be forced to severe austerity action.

A valid market concern is that Scotland would not be able to maintain a peg in some situations or attempt to devaluate the currency, for example to increase the competitiveness of Scottish exporters. This is a dangerous one-sided option. The Scottish currency could only decrease in value but not increase again (Kay, 2013). A likely outcome is that interest rates would increase or that parts of Scottish business would be done in another currency, or both. Scotland’s own central bank is then in the situation where it has to closely follow the actions taken by the reference central bank in order to keep the rate balanced. It can be, for example argued that Denmark’s monetary policy is de facto conducted by the ECB (Kay, 2013). Denmark is not part of the Eurozone but has pegged its rate to the euro and will have to consistently adapt to ECB policies without the ability to influence them.
This dependency might, however, even take place if Scotland decided to let its currency float. This is shown by the case of Sweden. The Swedish krone is not pegged to any currency but, in order to enjoy a relatively stable exchange rate to major Swedish trading partners, i.e. the EU, Sweden has to react to policy changes of the Eurozone (Kay, 2013). So the promise of complete independence coming from having an own currency that is freely floating might likely only exist in theory. Additionally, as for example noted by Julius (in Financial Times, 2014) transaction costs for businesses operating cross-boarder would increase and the initial period of uncertainty following independence may cause capital flight. The transaction costs could be controlled to a certain extent by regulatory framework allowing easy, cheap and fast transaction of money, which then, on the other side, could be used for currency speculation.

5.1.5 Summary

All in all, Scotland has various currency options but none of them seems altogether satisfactory. In the end, it is a trade off between autonomy and security or certainty. The option of the unilateral use of the pound seems to be, in theory, the middle way. But this would be unchartered territory and come with great uncertainty. The best economic outcome for Scotland, as acknowledged by the Yes-camp, would be currency union with the RUK (Scottish Government, 2013c). This could, though, put a drastic end to the dreams of fiscal autonomy linked to political independence. This leaves the option of a new Scottish currency, which would likely, at least in the beginning, be pegged to the pound sterling. While this could lead to a relatively difficult start of independence, it can be assumed that Scotland could over time develop a respected and internationally well tradable currency, as many other countries have. Arguably this scenario would not live up to the hopes and expectations of Scotland. This, however, as Kay (2013) puts it, "reflects the acknowledgment of a central reality". The level of economic independence countries, such as the aforementioned Denmark and Sweden, enjoy when trading with large partners or currency unions, is simply limited. Still those two, and many more, are wealthy and prosperous countries.
5.2 Fiscal Policy

The considerations about independent Scotland’s fiscal policy are, as explained in chapter 5.1, closely linked to and dependent on the currency choice. This chapter takes the approach of looking at good fiscal policy in general and discussing the implications for Scotland.

According to O’Donnell (2013), good fiscal policy should be sustainable, supporting the economy and enhancing (social) equity. The first one refers to the principal that government spending should be in general matched by collected revenues. If not, debt level will rise, which also means interest payments increase, leading ultimately to higher risk for creditors. This would be compensated for by increased interest rates, which again lead to more borrowing and by chance to an explosive situation. Sustainable policies can exist with high debt levels, too. It does, however, require bigger primary surpluses (O’Donnell, 2013).

Supporting the economy means, first of all, acting as a stabiliser. Fiscal policy plays an important role in managing shocks and tackling imbalances (Allsopp and Vines, 2005). It should in the long run also aim to enhance productivity and generally deliver a stable system for all participants. Taxation plays an important role, too. Finding the right mix is crucial as well as difficult. A Scottish government could take advantage of this and set incentives that best fit the needs of Scottish businesses, for example.

The last characteristic aims at providing balanced support. Fiscal policy should also be used to redistribute income between both people and generations. A growing concern is, for example, the widening of the income gap in many societies. This is particularly true for the UK (Organisation for Economic Co-operation and Development, 2011) and hence would be a main challenge for an independent Scotland.

Additionally Scotland will have to face an increasing number of older people needing expensive health care while the number of people working and paying taxes decreases (Lisenkova and Mérette, 2014). According to Emisch, et al (2009) Scotland should indeed be, more than other similar countries, concerned with its aging population and shrinking labour force and will have to find ways to address the economic consequences. Also the Scottish system tends to be more generous than the current UK system in terms of welfare spending. According to the plans of the SNP, spending should be even
further increased (Scottish Government, 2013c). Given the importance of income from North Sea sources, and its relative volatility, this would require even more careful budget planning. In addition, as global competition keeps continuously increasing, the pressure to produce at the lowest possible costs grows, also regarding energy and tax costs. So countries trying to increase their competitiveness through lowering taxation could end up in a dangerous race to the bottom.

All in all, an independent Scotland would have the chance to create a stable and beneficial fiscal policy framework, including a tax system tailored to its specific needs and without the toxic complexity of the UK system. This is under the assumption that Scotland would enjoy significant freedom in its policy design and overcomes an initial period of turmoil possibly directly following independence. Also, while North Sea revenues promise wealth and hence less pressure to collect money from other sources in the following decades, they will not flow forever and should, at least partially, be retained. In the future Scotland will have to face challenges for which it would be advised to save already.

5.3 Scotland’s Financial Position

One major change independence would bring is that Scotland would be responsible for its financing entirely alone; this is currently done by the Debt Management Office from London (Goodhart, 2013). Already from its Independence Day on, Scotland would most likely have to face considerable amounts of debt, simply inherited from the UK. The exact amount is very difficult to predict and would, obviously, depend on negotiations and the amount of UK debt at that time. Two models have been suggested that try to give an approximate picture of the situation. The first one bases the calculation on a per capita, the second one on a historic share. Historic information on public spending and tax receipts in Scotland has been gathered since 1980 and published in the Government Expenditure and Revenue Scotland report (Scottish Government, 2012b). As roughly 90 percent of UK debt has been accumulated in the last 35 years (Scottish Government, 2013d), the historic share model uses this data.

A Scottish government calculation based on the two models using the figures for UK total debt of £1.1 trillion from 2012 yielded an estimated public sector net debt for Scotland of £92 billion (per capita share) and £56 billion (historic share; Scottish Gov-
This means that Scotland’s debt to GDP ratio would be around 63 (per capita share) or 38 percent (historic share). On a future Independence Day, these numbers are likely to be higher; already in June 2014, UK public sector net debt reached about £1.3 trillion (Office for National Statistics, 2014a). Using the calculation based on a population share of 8.5 percent, this would bring Scottish debt up to about £110.5 billion. Both scenarios would leave Scotland with a lower ratio than the UK because Scotland’s GDP per capita is slightly higher than the UK average due to offshore revenues (62 or 38 percent for Scotland and about 72 percent for the UK in 2012 (Scottish Government, 2013d)).

The management of the then existing debt and borrowing more would ergo be an incremental part of Scotland’s Finances. The structure of its institutions dealing with public finances would largely depend on the currency adopted. Besides the estimation of public sector net debt that can be done with some prudence and the question how the debt would be transferred and restructured, which, however, is too detailed for the scope of this thesis, an important consideration is the cost of future borrowings in independent Scotland. Goodhart (2013), for example, states that “Scotland might face an additional risk premium on its own debt”. One reason for premia is that the volume of a new debt issue is relatively small, thus trades less frequently and has therefore a larger bid/ask spread (Goodhart, 2013). If Scotland were to decide to issue amounts big enough to boost liquidity, it is reasonable to assume that those amounts would be relatively large compared to Scotland’s overall finances. Repayments could come at an inappropriate time and refinancing between large issues of debt would have to rely on short-term financing. Goodhart (2013) uses the finding of Bernoth, van Hagen and Schuknecht (2004) that “an increase of the relative debt size by one percent causes a reduction of the issuer country’s interest rate by around 0.7 basis points” to calculate that Scotland could be faced with interest rates up to almost one percent higher than the UK due to liquidity premia.

It should also be noted that markets, with the experience of the euro crisis in mind, would likely require higher interest rates. Even in a currency union with the RUK, Scotland might be seen as a small and peripheral part, even more so if it decided to join the Eurozone (Goodhart, 2013). If Scotland would have its own currency, risk premia would likely be even greater as exchange rate risks for any non-Scottish institution would have to be added. So there is definitely a lot of uncertainty regarding Scotland’s
cost of debt and it is impossible to prudently predict an exact rate. It can be assumed that Scotland will face relatively larger costs (than the UK), in particular in the first years following independence, when it has no established record as a debtor yet.

Another question of similar difficulty is how Scotland’s financial position would develop over time. The Scottish Government projects a sound long-term financial position for Scotland (Scottish Government, 2014a). This projection relies heavily on strong economic recovery and high revenues from North Sea oil and gas. It is furthermore obviously written with a political purpose. So generally, it can be said that Scotland’s finances will very much depend on the development of its own and the global economy and on decisions by the elected governments.
6 Microeconomic Themes

After discussing the dominant macroeconomic factors, the focus of this part is on microeconomic considerations. At first, the impact of greater autonomy on growth is analysed from this perspective. Afterwards, key industries of Scotland’s economy and their interrelationship with independence is evaluated. The main focus is on Scotland’s oil and gas industry.

6.1 Impact of Greater Autonomy on Economic Growth

One of the central arguments of Scottish nationalists is that transferring more, and ultimately full, power from Westminster to Holyrood would enable Scotland’s economy to perform stronger and grow at a higher pace. They point at Scotland’s improvement in for example productivity, gross value added (GVA) or employment, all relative to the UK average, since devolution (Scottish Government, 2013d). The Scottish government argues that this is due to its “ability to use even limited levers in the interest of Scotland” (Scottish Government, 2013e). While it is beyond the scope of this paper to examine in detail whether those improvements can in fact be linked to devolution, the general assumptions that more devolution directly leads to greater efficiency and increased economic growth has been challenged in earlier studies. Bwire and Rodríguez-Pose (2003) for example found “no evidence of a positive and robust correlation between the inception of regional autonomy or of increases in transfers of resources to regional and state governments and a better economic performance than under a more centralized regime”. Also according to McLaren et al (2011) Scotland’s overall economic performance was very similar to the one of the UK as a whole since the devolution of 1998.

Nonetheless, the Yes-camp argues that Scotland is kept beneath its actual potential by the central UK government. This is illustrated by, for example, the average annual growth rate of GDP in Scotland and the UK: Between 1977 and 2007 that rate of Scotland was 2.4 and the one of the UK 2.9 percent (Scottish Government, 2013f). In contrast, it should be noted that now the GDP per capita of Scotland (£20,571 excluding
oil and gas) is very close to the average of the UK (£20,873; BBC, 2013). It is, however, important to take the regionally polarised economy of the UK into account. There are only two regions, London and the South East, that have values above the average. Together they account for about 37 percent of total UK GVA (Office for National Statistics, 2014b). So in this context the argument that Scotland could improve as an independent country is not surprising.

One, to some extent, simplified way to approach the question of how Scotland’s economy would develop with greater autonomy/independence, is to look at the impact on the country’s GDP. Although using GDP to measure prosperity can be criticised (Stiglitz, Sen and Fitoussi, 2009), it still gives a good general overview of economic performance and can be relatively easily broken down into its parts. These parts can then be analysed with reference to the changes that independence would assumingly cause.

McGregor and Swales (2013) have taken this approach. They look at it from a supply-side perspective and identify population, participation rate and labour productivity as key determinants for economic growth (measured in GDP). Over the last decades Scotland has had a stable population level of slightly above five million people (National Records of Scotland, 2014). For economic growth a growing population is desirable, especially in terms of skilled people. In this way, a favourable labour market would increase immigration (of skilled workers) and simultaneously reduce out-migration due to economic reasons.

One factor influencing the participation rate is demographics. As already mentioned several times, Scotland is faced with an aging population; the greater the population share of retired people, the smaller the amount of people who are able to participate/work. This again shows the importance of dealing with the issue of aging population and how important a focus on immigration may be. Also typically wealth, health and childcare, skill and labour demand policies to have a positive effect on the participation rate (McGregor and Swales, 2013), which could perhaps be more in the focus after independence. Currently, Scotland enjoys a participation rate slightly above UK average (Office for National Statistics, 2014c).

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5 GVA is used in this case due to the lack of comparable GDP data.
Regarding labour productivity, McGregor and Swales (2013) identify a number of factors of importance, for example the contribution of capital. They also point at human capital and how labour productivity is positively affected by an increase in human capital. As Scotland is known for having some of the best universities in the world and a great education system in general, this factor is particularly dominant. Hermannsson et al (2012: 21) find that maintaining the level of annual graduates from Scottish universities of 2006 will, in the long run, increase Scotland’s GDP by six percent.

Perhaps the most crucial component of labour productivity is technological development (McGregor and Swales, 2013). The way technological change may take place is also influenced by the institutional setting (Acemoglu and Autor, 2012), which would be obviously impacted by independence. Additionally, technological development is driven by a skilled workforce and can, for example, be encouraged by governments through tax incentives (McGregor and Swales, 2013).

The level of government expenditure in an independent Scotland will obviously have a great impact on the previously mentioned key determinants. Currently, the budget for Scottish government spending is allocated through the Barnett formula (Ferguson, 2003). This means that the amount of money available for Scotland is determined by the amount the UK wants to spend and the population share of Scotland. As already mentioned in previous sections, public spending budget in Scotland is not related to taxes raised in Scotland or in any way linked to how much Scotland would need. One example in which this could lead to a disadvantage for Scotland is the financing of the higher education sector. If the UK, for example, decides to continue the push of university financing towards private funding and student loans, public spending would be reduced and, hence, using the Barnett formula, Scotland’s budget would also be cut by a relative share, even though Scotland might want to prioritise public financing of higher education more. The Scottish government does, however, have some freedom on where it wants to spend the money. So if the UK decides to cut spending on higher education, Scotland does not necessarily have to reduce its spending in that field simultaneously; it can also decide to spend less on other sectors.

Moreover, the Scotland Act 2012 will place more power in the hand of Scotland’s government, as for example varying the rate of income tax by up to ten percent and increased freedom to borrow money (Scotland Act 2012). However, it is questionable
that any Scottish government as part of the UK would be allowed to implement fiscal policy that differs drastically from the one of the central UK government (McGregor and Swales, 2013).

Another debate is about the impact (on efficiency) of the degree of local funding. Currently, and there is little change to this under Scotland Act 2012, Scottish finances do not directly profit from greater economic growth in Scotland. So with independence, or also greater devolution for a matter of fact, Scotland would be able to only spend the money it generates. This should arguably improve the efficiency and lead to better decision-making, which then turns into higher economic growth. Additionally, if the Scottish government has to rely solely on the taxes it collects, it should theoretically be more focused on increasing the tax base through economic growth (McGregor and Swales, 2013). Another argument discussed by McGregor and Swales (2013) is that a government that is not responsible for its own funding might not (have to) spend its money responsibly because it would be bailed out by the central government eventually. So this would encourage risky promises and decision-making and harm future growth. However, in the Scottish case, this argument is minor, as Scotland’s budget actually has to be balanced from year to year.

Furthermore, the behaviour of voters might be affected by independence. The assumption is that under the status quo, Scottish voters are not encouraged to vote for politicians with agendas focused on (long term) economic growth. Instead, voters supposedly favour political agendas with a focus on current spending, because Scotland and its people would hardly benefit from the growth, but receive all the benefits of increased current spending. According to McGregor and Swales (2013), this behaviour might change with independence and a more growth-oriented agenda would be implemented. On the other hand, there are also clear disadvantages of greater local funding. It is overall only beneficial if the growth in Scotland is greater than the average of the UK. Also the Scottish economy and the tax base are smaller and less diversified. This means greater uncertainty for tax revenues, in particular if taking into account the dominance of North Sea oil and gas, which are not at all guaranteed.

Another key point is the mix of taxes an independent country can set itself. Scotland does assumingly have better information about the local economy and can thus more efficiently channel (tax) policies (Fiscal Commission Working Group, 2013b). Scotland
could then also independently vary its corporation tax rate, for example. Ireland is often taken as a role model; after deploying a low corporation tax rate, its economy experienced rapid growth and great inflow of foreign direct investment (McGregor and Swales, 2013).

The border that would be placed between Scotland and the RUK is an important factor, too. In 2012, Scottish exports to the RUK were estimated at £47.6 billion (excluding oil and gas), meaning that exports to the RUK made up about 65 percent of all Scottish exports (Scottish Government, 2014b). Moreover, Ashcroft (2014) analyses that “almost 1 million jobs – 962,000 – depend on links to the rest of the UK”. It is, however, not clear, or in anyway easy to estimate, how a national border would impact trade. Looking at literature about the subject, Obstfeld and Rogoff (2001) state that there is “a considerable degree of home bias in trade”, meaning that trade within a country is greater than international trade. The most studied border is perhaps the one between Canada and the United States of America. Anderson and van Wincoop (2003), for example, find a significant impact of the border: they claim that “national borders reduce trade between the US and Canada by about 44%”. It is, however, not exactly clear what the underlying reasons are. But it seems reasonable that tariffs and non-tariff border barriers, exchange rate exposures and, to some extent, higher shipping/transportation costs play a role (Obstfeld and Rogoff 2001). Evans (2000) also suggests that social and cultural factors play a role, for example domestic networks and language.

While it is generally difficult to estimate the effect the new border would have on Scotland’s economy, some of the assumed reasons that seem to pose a big barrier could be minor in this case. The currency is an obvious example; keeping the pound sterling would most likely reduce the detrimental impact of a border. This is even truer if it were agreed that Scotland would stay in the Common Travel Area, a travel zone compromising the UK and Ireland where border control is reduced to a minimum⁶.

Moreover, the language is not a barrier in this case and also the existing level of integration of the economies indicates that business networks are well developed between

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⁶ It seems questionable that the plan of the Yes-campaign that an independent Scotland could be an EU member state and stay in the Common Travel Area would work. This topic has frankly not received much attention (Wright, 2013).
Scotland and the RUK. McGregor and Swales (2013) also argues that it is unlikely that “any government of an independent Scotland would not wish to encourage trade with the rest of the UK”. One aspect worth noting is though, that this might change over time. The Scottish government has pointed out that it would want to introduce policies, laws and regulations tailored to Scotland, i.e. different from the current ones. It can be assumed that greater difference in the regulatory framework might harm cross-border trade.

6.2 Scottish Key Industries

After discussing various macroeconomic themes and the general impact of independence on economic growth, another important topic is the linkage between independence and Scotland’s most important industries. In its Government Economic Growth Strategy report (2011), the Scottish Government identifies the sectors with significant economic impact and growth potential. These are:

- Creative Industries
- Energy and Renewables
- Financial Services
- Food and Drink
- Life Science
- Tourism
- Higher Education

All of them would be impacted by independence, some more than others. There is, for example, the question how the financial industry would react to independence and concerns have been raised that much of it would move to London (Goodhart, 2013). Other sectors that depend more on conventional exports, as for example the food and drink industry (Scottish Government, 2013f), would obviously be influenced by the choice of currency.

Another aspect, often argued by the Yes-campaign, is that an independent Scotland could introduce policies more targeted towards its local industries. It is claimed that currently the UK operates a regime that is more focused on English businesses, particular in the London area and the South East (Scottish Government, 2013g).
While all these considerations could be discussed in much more detail, the arguably most relevant industry to the independence debate is oil and gas. Even though the influence that independence would have on it might be limited, its development would be crucial to an independent Scotland state.

6.2.1 Oil and Gas

The output of North Sea oil and gas, relative to the UK economy as a whole and consequently also its contribution to UK public finances, is tremendous. For the fiscal year of 2011-12 the sector paid £11.2 billion in taxes (Kemp, 2013), making it the largest corporate taxpayer in the UK (PricewaterhouseCoopers, 2012), and employed around 450,000 people in 2012 (BBC, 2015).

As most of the oil (over 90 percent) and much of the gas (around 60 percent) are extracted from Scotland’s geographic share of the UK marine territory (the exact borderline would, of course, depend on negotiations; Kemp, 2013; Scottish Government, 2013b), it is not surprising that the topic of oil and gas has been much discussed prior to the referendum: the offshore revenues would be even more significant to Scotland’s economy. The Scottish government has outlined plans to use oil revenues to fund a greater welfare state and tax cuts, and even create an oil fund (Scottish Government, 2013b), similar to the ones established in many other oil-rich countries, such as Norway (Fiscal Commission Working Group, 2013c).

While oil revenues can definitely boost an economy and increase welfare, there is also a downside of oil being a big part of the economy. Oil, or rather the oil price, is extremely exposed to the global economy and external shocks. This means, although Scotland could try to introduce more oil industry-friendly (tax) policies, that a country can hardly do anything about falling oil prices, in particular a country of Scotland’s size. This risk of exposure to volatile prices is even bigger if a country uses oil tax revenues as part of its annual budget (some countries have established funds to ensure long-term benefits from their oil income (Recknagel, 2014). Figure 2 shows the development of the crude oil price in the last 25 years.
Figure 2. Weekly Europe Brent Spot Price in US Dollar (U.S. Energy Information Administration, 2015)

Even without detailed analysis, the graph illustrates the volatility of the oil price, especially in the last ten years. It furthermore shows how quickly the price can change. The recent development is of particular interest, as the price started to fall in the second half of 2014. But most of the forecasting about the finances of an independent Scotland was done earlier, calculating with then current, or even rising, oil prices. The Oil and Gas Analytical Bulletin from the Scottish Government (2013h) summarised forecasts from different institutions that all projected the oil price to be above $100 per barrel at the beginning of 2015. While some may argue that the recent decline came as a surprise and was not to be expected, there is an established history of missed oil price forecasts (Hasantash, 2012).

Of course, the actual tax income is not only affected by the oil price itself but also by production volume, investments and operating costs (Kemp, 2013) but the price is certainly a dominant factor here. An important point to make is that Scotland would be more exposed to this uncertainty than the UK currently is, given the relative size of the industry to the respective economies. So generally stated, Scotland would benefit more from high, but also suffer more from low oil prices, leading to greater swings in its economy and finances.
7 Critical Success Factor Analysis

The overview of the case of Scottish independence and the discussion of relevant economic aspects above have shown the complexity of this topic. Various parties with different political agendas, even including governments, research institutes and to some extent academics, focus on certain issues and stress the points that fit their objectives. This chapter builds on the discussion in previous sections, tries to defog politics and contribute to an informed debate by identifying and subsequently analysing the factors critical to the success of a newly independent Scotland.

The so-called Critical Success Factor (CSF) Analysis has been used by businesses for decades. The concept originates from work done by Daniel in the 1960’s and became increasingly popular after Rochart refined the term “critical success factors” in 1979. Rochart (1979) defines CSF’s as a “the limited number of areas in which results... will ensure successful competitive performance for the organization”. Originally developed to help managers and executives focus their attention and channel resources to what is deemed most important, its open-ended design makes its application valuable in various ways (University of Washington, 2011). Logically, there are multiple approaches and foci, for example on certain types of CSF’s. Usually, the starting point is to identify the overall goals and objectives of an organization (University of Washington, 2011).

For this particular scenario some general assumptions should be noted at the beginning: In the following analysis, the focus will be on medium- to long-term success. It is assumed that the electorate voted Scotland to become independent in the nearby future (one to two years from now, during which fair negotiations take place), that Scottish governments will broadly follow suite with current overall policy ideals and that the global economy is reasonably free of drastic shocks. These assumptions are made in order to avoid having to debate very general CSF’s7.

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7 Without making these assumptions, one would arguably have to start from a more fundamental point and, for example, consider the continuing existence of the state and the democratic system as critical factors for economic success.
The first question to answer is what the objective in this case is. Besides the political demand of self-determination, there is the central claim that Scotland would be “better off” economically and financially as an independent country. So independent Scotland’s objective can be broadly identified as having sound state finances, a performing and growing economy, and a population which enjoys increased wealth and welfare, all relative to the RUK and prior performance\(^8\). The following factors that are critical for the achievement of this can be identified:

- Currency Management
- Oil and Gas
- Population
- Exploitation of new Opportunities

The first factor, currency management, has been discussed extensively in this paper. It has been demonstrated that there is no one best currency option (see also Financial Times, 2014). Thus, it is even more important to, regardless of which currency is adopted, follow suite and establish a consistent, realistic policy framework focused on the strengths of the chosen option. Scotland’s success will depend on a range of questions following the decision, for example; to what extend will Scotland be able (in theory and practice) to exercise monetary policies tailored to Scottish needs and will Scotland be forced to adopt (rigorous) stabilizing and austerity practices?

Another CSF is the revenue from North Sea offshore activities, namely from the oil and gas industry. As has been discussed, this sector is the major contributor to the economy and state finances, and logically extremely important to the objective. As Scotland is a much smaller country than the UK, its economy would be less diversified, making Scotland’s economic fortune more dependent on fossil resources. With a booming oil industry Scotland could likely become a richer country and pass this on to its people. However, with declining oil income Scotland would find itself in a much more difficult position and would have to find other sources of income to outgrow the RUK. It should be noted that this CSF can hardly be controlled by Scotland. Of course, Scotland could, and might be well advised to, introduce more sector-friendly policies and understand itself more as an “oil state”. Nevertheless, the (global) oil price is the main determinant here, and Scotland is a relatively small player in the oil business in a glob-

\(^8\) Of course, the goals mentioned could be specified further. But the idea here is not to state that by doing one certain thing GDP would, for example, grow by half a percent.
al context. But an independent Scotland should, at least, consider carefully how to use the oil income and possibly try to find long-term investment strategies for it. This might mean to give up on some short-term promises.

Population is listed as a CSF for multiple reasons. Firstly, the size of a country’s population has a great impact on the growth of the economy (as shown in section 6.1). Moreover, Scotland faces the challenge of an aging population. This is a critical issue that definitely needs to be addressed if Scotland wants to outperform the RUK, in particular because it seems to be a greater issue for Scotland than it is for the RUK.

Here immigration is a factor, too. Scotland will have to find suitable immigration policies in order to attract the needed skilled workers for its economy (and tax base). Additionally, the whole subject of human capital is becoming more important. Education plays a crucial role in equipping the population, and hence the (future) workforce with a useful skillset. Scotland has always seen itself as a leader in higher education and keeping this role will be essential for success.

Another CSF worth mentioning is the exploitation of new opportunities. The Scottish government has made it clear that it believes that Scotland does not benefit from current UK policies and that under independence Scotland would have the opportunity to introduce policies tailored to Scottish businesses’ needs. One example often mentioned is the renewable energy industry, which has received more attention in Scotland than in other parts of the UK and certainly has a high potential (Carstairs, 2013). The key here is that Scotland would have to focus on these new opportunities and on creating even more innovation. This is particularly important to Scotland, as its economy is less diversified and will have to reinvent itself constantly to stay competitive. Scotland will have to make sure it takes advantage of its unique opportunities; otherwise it will quickly fall behind both the RUK and its own expectations.
8 Conclusion

The aim of this research was to identify and analyse the most essential factors for the economic success of Scotland in the case that it were to become an independent country. In order to do so, this thesis firstly outlined the set of constitutional arrangements feasible for Scotland. Already that discussion showed constitutional independence does not necessarily lead to full (economic) autonomy. The degree of autonomy would rather be determined by policy choices made after independence. One of the predominant factors identified is the choice of currency and subsequent monetary policy. While Scotland, in theory, could pick from various options (joining the euro, keeping the pound as part of a currency union or unilateral action, or creating its own currency), all of the options have constraints and would most likely limit the freedom of Scottish policy makers. The success of independence would also heavily depend on the fiscal framework implemented and Scotland’s overall finances.

Another part of this research was devoted to the impact greater autonomy would have on economic growth from a microeconomic perspective. With independence, Scotland could introduce an agenda tailored to its own needs and would no longer have to share the same strategy with the entire UK. On the other hand, the economy of a small country is typically less diversified and more sensitive to shocks; Scotland’s economy and finances would heavily depend on the oil and gas industry. While this sector can be the source of large revenues, relying on its contribution to annual budgets comes at a risk, as the recent development of the oil price clearly shows.

Albeit turned down by the electorate in September 2014, the scenario of independence remains fascinating. While most agree that independent Scotland would be in a sound position, the grand number of variables makes reasonable estimation close to impossible. This thesis identified, using the Critical Success Factor model, four aspects (currency management, oil and gas, population, and exploitation of new opportunities) that would largely determine the economic development and hence success of independent Scotland. Although no government has complete control over these factors, each of them will play a key role for Scotland. Consequently, addressing the issues and questions of these topics should be made a priority in any future attempt for independence.
This thesis produced a comprehensive analysis of the dominant economic topics of the Scottish independence debate. This generic approach did not, however, allow in-depth discussion of all the aspects. So, by nature, the focus was on the topics identified as predominant. Further research could thus be concentrated on other details of the debate. It could also be useful to analyse various concrete scenarios or to identify similarities with independence discussions in other regions of the world.
References


