HOUSE OF LORDS

Unrevised transcript of evidence taken before

The Select Committee on Economic Affairs

Inquiry on

THE ECONOMIC IMPLICATIONS FOR THE UNITED KINGDOM OF SCOTTISH INDEPENDENCE

Evidence Session No. 12. *Heard in Public.* *Questions 526 - 640*

WEDNESDAY 24 OCTOBER 2012

10 am

Witnesses: Professor Charlie Jeffery and Jeremy Peat

Professor Alex Kemp

Rt Hon Alistair Darling MP

Ruth Davidson MSP, Patrick Harvie MSP, Johann Lamont MSP and Willie Rennie MSP

Owen Kelly and David Nish

Elspeth Orcharton, Jeremy Purvis and Professor Jim Gallagher

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Members present

Lord MacGregor of Pulham Market (Chairman)
Lord Forsyth of Drumlean
Lord Hollick
Lord Levene of Portsoken
Lord McFall of Alcluith
Lord Tugendhat

Examination of Witnesses

Professor Charlie Jeffery, University of Edinburgh, and **Jeremy Peat**, David Hume Institute

Q526 The Chairman: Good morning, gentlemen. Good morning, everyone. Welcome to the Economic Affairs Committee. This is the first time that we have had a meeting outside London and it is the 12th evidence session of our inquiry into the economic implications for the United Kingdom of Scottish independence. Let me begin by thanking the City of Edinburgh Council and its chief executive for allowing us the use of this splendid meeting room—I am grateful to all those who have helped to arrange it for us. We decided—in fact we have been going since about May—that we should make the subject of our inquiry this one: the economic implications for the United Kingdom as a whole. I stress the United Kingdom as a whole, because there are economic implications for the rest of the United Kingdom, as well as for Scotland, and these we have been exploring too. We have Members of our Committee who come from those areas but who are not here today.

The reason for this inquiry is that it is clear to many of us that there should be a full understanding of the economic implications of Scottish independence before the vote on the referendum takes place. When we began this inquiry, we as an economic Committee felt that there had to be a proper investigation of many of these issues in public. That is, to some extent, still the case. We are very anxious to explore these issues in detail so that everyone has a clear understanding of the economic implications. That is the purpose of our inquiry; we are looking not at constitutional, political or legal issues, but purely at the economic issues—I stress, for the United Kingdom as a whole. So we have a fairly intensive two days. Let me begin by very much welcoming Mr Peat and Professor Jeffery for setting the sort of background for the whole of our two days' inquiry. Is there anything that you would like to say, or would you prefer to go straight into questions?

Jeremy Peat: Lord Chairman, I have just one very brief comment. I welcome what you were saying about the importance of spending time now finding out what the issues are and exploring them. We have roughly two years before a potential vote, and it is important that that time be used for that purpose. There are many complex issues to be examined, some of which certainly I have just started examining and identifying. It is too early to look for answers to most of the questions, but it is by no means too early to start determining what the key questions are.

Q527 The Chairman: On that, I would say that now we are not only clear what the questions are—and we had a very useful session with Danny Alexander, the Chief Secretary to the Treasury, last week, which raised a number of the questions that we will be exploring in the next two days—but we are beginning to get some understanding of the implications pretty clearly, and that is the purpose of our inquiry. Perhaps I may start by asking you this: the SNP has said that an independent Scotland would continue to use sterling. I know it has sometimes not been clear exactly what the party's view is about that aspect of the whole issue, and we have looked at four different options for the way that this could happen. What do you think would be the best currency option for an independent Scotland from a Scottish perspective, and even perhaps from the perspective of the rest of the United Kingdom?

Professor Charlie Jeffery: Thank you. The debate here is now dominated by that single option—if Scotland votes yes, it will use the pound sterling. That is an option that has attractions for the advocates of independence by providing a sense of reassurance and continuity, but I think it is probably also an option that has significant popular resonance. So I think in both senses, with a special emphasis on popular resonance—we perhaps all too easily lose sight of what citizens think and want—the pound sterling is the best option in an independent Scotland.

Jeremy Peat: I agree with that. There are a whole host of interdependencies between the economy of Scotland and the economy of the rest of the United Kingdom. That constitutes a very good reason, at least initially, for the maintenance of exchange rates to create certainty between Scotland and the rest of the UK, and hence continuing with sterling as the currency has advantages. But of course that leads to the key issues of how sterling can be retained and what that implies for other aspects of economic policies.

Q528 The Chairman: Can I come to one of the key issues? If an independent Scotland maintained sterling, it would have to be bound by a fiscal pact. Do you agree?

Jeremy Peat: If an independent Scotland retained sterling as part of a sterling currency area, then I am sure that there would be negotiations between the new Scottish Government, the Bank of England and the Treasury as to exactly what that meant in terms of constraints on the operation of fiscal policy and our policies in an independent Scotland. So, exactly what outcome would emerge from those discussions is unclear, but particularly given the eurozone crisis, it is increasingly clear that there would be a need for some agreement on constraints on fiscal policy in an independent Scotland, as part of a sterling union.

Professor Charlie Jeffery: Might I add a note to that? We have heard from the Scottish Government's perspective some initial thoughts on how fiscal policy co-ordination might be managed following a yes vote, but not yet in a great deal of detail. What we have not heard, and what we are probably less likely to hear, are the conditions in which the UK Government might approach such a pact. We are in a strange situation in the wider debate, in that the advocates of independence have a strong interest over the next two years in proposing terms under which independence might be operational. There is probably less incentive on the UK Government side to match that, given that that signifies a recognition that independence might happen. So we are probably likely to have a slightly imbalanced debate with more input in due course from the Scottish Government side and perhaps less reciprocal imagining of how this would happen on the UK Government side.

Q529 The Chairman: Have you had a chance to look at the evidence that the Chief Secretary to the Treasury gave us last week?

Professor Charlie Jeffery: I have not.

The Chairman: If you look at that, you will see that he put significant emphasis on the implications for the UK as a whole and, in particular, he draws attention to—as Mr Peat has done—the crisis in the eurozone, which has very real lessons, looking ahead, for this issue as far as Scotland and the rest of the UK are concerned.

Q530 Lord Tugendhat: Can I ask this question? I think that you would agree with me that the formation of economic and monetary union and the single currency in the eurozone was perceived by the member states, first, as being irreversible and, secondly, as being a step towards closer union. It remains to be seen what happens, but those were two underlying assumptions and commitments. If we had a pact between a newly independent Scotland on the one hand and the rest of the United Kingdom on the other, surely we would be in the reverse situation. Scotland would have broken off from the United Kingdom, so, whereas the continental countries were coming closer together, in this case Scotland and the rest of the United Kingdom would be going further apart. In view of the fact that the whole drive for independence, as I understand it, is posited on the assumption that Scotland would be able to run its affairs better alone than as part of a United Kingdom, the assumption of outsiders would surely be that, far from being irreversible, this was a temporary accommodation until Scotland could do something of a more independent nature. So it is the mechanisms of the eurozone with all the difficulties that that implies, but, oddly enough, going in the reverse direction.

Professor Charlie Jeffery: You point to a very interesting contrast, which suggests that we are in unprecedented territory in considering the possible arrangements of the relationship that an independent Scotland would have with an independent rest of the UK. I would add a qualification to your sense of inevitability and irreversibility in that process, in that in Scotland and in other places around the world—advanced democracies which have pro-independence movements—the vision of independence is highly qualified, involving high levels of continuing partnership between the successor states of the current state. That sense of inevitability of moving ever further up is not one, I think, that will be shared by proponents of independence here or in Quebec, Catalonia or the Basque Country—to name the most obvious examples. So irreversibility is not necessarily the constitutional imagination in these places and in Scotland.

Lord Tugendhat: I take that point, and I share the view that you have just stated, but if one is trying to look at it from the point of view of markets, the eurozone was given a lot of leeway by markets for a long time because it was presumed that it was irreversible and a step towards closer union. The point that you have just made is one that an independent Scotland and the rest of the United Kingdom would have to convince markets of, because it would appear to run contrary to what the earlier debate had been. So there is a difference between perception and reality.

Q531 Lord Forsyth of Drumlean: Professor Jeffery, everyone says that there would have to be some kind of fiscal pact. This was decided when we embarked on European monetary union and we had the so-called Maastricht criteria, and Germany and France were the first to break the Maastricht criteria. The goalposts kept being shifted and we have ended up now with a crisis that is afflicting Greece and the other southern European countries, including Italy. If there is a fiscal pact between an independent Scotland and the rest of the UK, how exactly would this be enforced? How could you make sure? “Fiscal pact” is a technical term, but what it means is that the amount of money that Scotland is able to spend and borrow would have to be agreed with Westminster. I cannot see what mechanism would exist to ensure that that would be delivered and be effective. I remember during the 1990s the SNP running a very effective political campaign, when interest rates were being put up to squeeze out inflation, saying that Scotland was suffering from the overheating of the south-east and interest rates were being set to reflect the conditions there. If an independent Scotland was to have the pound, interest rates would be set literally to deal with the conditions south of the border. It is not clear to me what the mechanism would be whereby a Scottish Government would be able to influence the amount that they were able to spend and borrow and the interest rates that were being charged. If that is the case, would we not be considerably worse off economically in terms of the operation of the economic levers? I hope that that is not too much of a loaded question, but it is a genuine puzzle for me that the proponents of this idea of using the pound have so far have not explained.

Professor Charlie Jeffery: I may pass on to Jeremy to follow up on this point. The heartland of the issues is the kind of agreement that would be negotiated between the two Governments and ultimately whether that agreement was sufficient to maintain credibility in international financial markets. The discussion around that and market reaction around that would, I imagine, have some focus on the conditions and compliance mechanisms around those conditions. I suspect that, if those compliance mechanisms were insufficient, they would then express their views in ways that we have seen elsewhere.

Lord Forsyth of Drumlean: Forgive me interrupting you, but I am not asking about the mechanics of how you would do it; I am asking about how it would be enforced. In the European Union, for the euro, the enforcement mechanism is fines being imposed by Brussels, but it is not clear to me how you could enforce such a fiscal pact here.

Professor Charlie Jeffery: That again would be a matter for the two Governments in setting up the founding conditions of a sterling area of which an independent Scotland was to be a part. I cannot foresee what those conditions would be or what the particular negotiating positions of the two Governments would be in setting it up.

Lord Forsyth of Drumlean: But you recognise that there would have to be a stick with which Westminster could beat a Scottish Government if they were to depart from the agreed fiscal pact.

Professor Charlie Jeffery: I am sure that they would not use that terminology, but I think that, for credibility's sake, both parties—not simply the Scottish party—would have to agree to particular limits and the way that those limits would be policed.

Q532 The Chairman: John Kay was giving evidence to us earlier and he suggested that you could have a looser fiscal pact if the following three principles were established: first, that the Scottish Government could borrow; secondly, that the Scottish Government would be responsible for their own debts; and, thirdly, that the English Government would have no liability whatever and that it would be clear to people on the international markets that it had no liability for the debts of the Scottish Government. Would you agree?

Professor Charlie Jeffery: I would defer to Professor Kay's expertise in these matters.

Jeremy Peat: Can I just answer the points that have been made? First, on the initial establishment of the European single currency area, it is clear that it was critical that it be seen to be irreversible, but unfortunately there was not full adherence from the start to the pre-announced Maastricht criteria. One of the biggest problems to me was the debt-to-GDP ratios of several member states, which were assumed to be close to the level that was permitted when they clearly were not. That set in hand the risks that followed. Having seen the risks that resulted from country after country entering with high levels of debt-to-GDP compared to the Maastricht criteria and the strains that that imposed, I think that all countries contemplating anything akin to that will be more cautious in the future. I think that this is a different circumstance, as has been pointed out, from that particular arrangement, but there are lessons that can be learnt as one goes forward and will no doubt be learnt.

So far as how one manages any fiscal compact is concerned, I, too, always listen very carefully to what Professor John Kay says and take great care about taking issue with him. What would be of most concern would be whether any excess debt in Scotland put at risk the stability of the financial system and the economy across the UK. The criteria that John set out, if implemented, would tend to diminish the risks of such instability and disruption. At the same time, one has to remember that the UK Government have conditions and their own fiscal terms that they have set in the past and the present. They have set up their own means of monitoring those through the Office for Budget Responsibility, which is charged with giving advice twice a year on whether the UK Government, on existing policies, are set to meet their two objectives. I see no reason why there could not be arm's-length examination of whether a Scottish Government were meeting any requirements that had been agreed in the draft just as the UK Government have the examination from the OBR. That would lead to the complexity of what tools one had in order to cause change to any Scottish Government policies, but the same arm's-length examination would at least provide information for those Governments as to what was likely.

Finally, on the point about interest rates, Lord Forsyth is quite right that the interest rate would be set to the interest of the rest of the UK. At the moment, the Bank of England looks at the interest across the UK, but if we were in a different situation, with the rest of the UK running its policies and Scotland latching on somewhere within the union, there would not be the same explicit recognition of the issues across Scotland as there is at the moment. The impact on interest rates of conditions in Scotland is relatively limited at the moment, so I do not think that it would be a major change. Scotland has a very similar economy at the moment in many ways to that of the rest of the UK.

The Chairman: We will come on to that, because Danny Alexander would disagree with you. He was very explicit about the dangers of higher interest rates in Scotland. I understand that Professor Jeffery has to go at 10.50, so we will move on.

Q533 Lord Levene of Portsoken: Clearly, it seems that there are only two options: one is to remain with some kind of link with sterling, whatever arrangements are made; the other is to join the euro. In relation to the second option, do you know whether any calculations have been made about what it might cost Scotland to be in the euro? If we look at what has happened recently in the euro area, we can see so many problems. There are recipients and there are contributors. Has anybody calculated how much it might cost Scotland, if we take today's economic situation? Would Scotland be a Greece or a Germany?

Professor Charlie Jeffery: Let me have the first go at that. We have learnt in the newspapers today that we have not yet had a full exploration of many of the issues around the European Union and I am not aware of any calculations of the costs and benefits in any detail. However, I think you are focusing at least in part on the rebates that the UK has defended and will be seeking to defend in the upcoming negotiations. If the rebates were applied in some way to Scotland, it would be an easy calculation to make. That is because Scotland is more or less bang on the UK average on most economic indicators. The big question is: what would the terms of an independent Scotland's membership of the EU be and would that particular benefit be extended to an independent Scotland? We are not in a position to provide a full answer to that question, although I would like to hazard an opinion, if I may, on how the question of Scotland's EU membership might proceed.

We have heard a lot of commentary about legal opinions. There are legally informed viewpoints which suggest that Scotland would be an equal successor state to the rest of the UK, and there are other legal viewpoints that Scotland would not, and would have in some way to seek EU membership afresh. Adjudicating between those viewpoints will be a major enterprise for academic and other lawyers over the next couple of years, but ultimately I think that the law will be one part of that discussion and politics will be the other. I say that for a number of reasons. First, it would be very hard against the EU's own criteria to suggest that Scotland would be a problematic member in terms of the Copenhagen criteria on democratic governance and in terms of compliance with the acquis communautaire. If Scotland had experienced a referendum in which the advocates of independence were saying that Scotland should be a member of the EU, and if that referendum produced a clear result, that would produce a certain momentum for the EU to recognise that result. I do not mean necessarily that it would confer automatic membership, but certainly there would be an expectation of negotiation bilaterally between the Scottish and the UK Governments, trilaterally involving the Commission and multilaterally involving EU partners. They would set the terms of Scotland's membership, including questions about the rebate. I do not think that Scotland would ever leave the EU, but I think that there would be a period of quite difficult negotiations on establishing what the terms of its membership would be.

The Chairman: I am afraid that time is getting short and we must move on.

Q534 Lord Levene of Portsoken: Historically, Scotland, and Edinburgh in particular, has always been a major and very successful financial centre, although of course recent events have put a dent in everybody's reputation in that respect. Would an independent Scotland limit the size of financial institutions which could be headquartered there, as its tax base would be too small to bail out a large failing firm? That is because it is clear that, in past years anyway, Edinburgh was punching well above its weight. What regulatory arrangements would you want to see for large systemically important financial institutions, such as RBS, which headquartered in Scotland?

Jeremy Peat: I think that it is as yet uncertain exactly how arrangements might pan out for regulation, for lender of last resort and for catastrophe cover, if you like, for financial institutions within the context of sterling if Scotland remained within the sterling area. I think that that is one of a set of issues that would need to be debated. There is an indication, or a statement, that the expectation is that the Bank of England would remain the lender of last resort, but again arrangements would have to be made as to how the apparently different regulatory bodies would operate so far as Scotland is concerned. If Scotland was a member of the EU within this context, there is again the question of how EU regulations would apply: whether it would be necessary for Scotland to have its own financial services regulator as part of its membership of the EU; whether it would need to have its own independent central bank as part of that requirement; and how the interactions would take place between the Bank of England and the regulators down south and any bodies that existed in Scotland. That is a complex nexus which I am afraid I am not at the moment sufficiently qualified or informed on to say much about. But certainly the question of scale would apply, at least until such time as there was clarity on exactly how regulation would apply and how cover would be there for the last resort lender and for dealing with any catastrophic risks. I am sorry not to be able to say much more at this time, but it is very complex.

Q535 Lord Levene of Portsoken: Can I just put in a supplementary question that occurred to me while you were speaking? If Scotland were to join the euro, and RBS remained primarily a major bank in sterling, how would that match up in terms of support from the Scottish Government?

Jeremy Peat: The question would be whether RBS then became a rest-of-the-UK headquartered bank or a Scottish bank, and likewise for HBOS or any other financial sector institution. Even within a sterling union, these financial institutions would need to make a choice as to whether they were based in the rest of the UK with their main regulation and relationships being south of the border or whether they wished to be global UK bodies headquartered in Scotland, and then dealing with the regulation and other matters that are primarily fed through Scotland. I know from talking to colleagues at Scottish Financial Enterprise and elsewhere that they are trying hard to work through the different issues related to this not only so as to provide advice for their members, but also to try and get answers to exactly how some of these different aspects would work. They are making some progress and they are just beginning to unravel some parts of the complex web that this is.

The Chairman: We will return to that point with later witnesses.

Q536 Lord McFall of Alcluith: I would like to look at the issue of fiscal policy. In a paper for your institute, Jeremy, David Bell and Bob Elliott stated that "it is realistic to assume that monetary union would also entail co-ordination, if not integration, of fiscal policy. Therefore, an independent Scotland would have no command over one major instrument of macroeconomic policy, monetary policy, and limited control over another, fiscal policy." Do you agree with that and could you expand on it?

Jeremy Peat: I think this goes back to the point that we discussed earlier, which is, with Scotland remaining in a sterling union with the rest of the UK, whether the fact that it was relying on the Bank of England for the setting of monetary policy, and to some extent for financial sector regulation, matters.

Lord McFall of Alcluith: I think that what I am getting at is the response given last month by Alex Salmond in Chicago. He said, "We can have plenty of room for manoeuvre within a currency union." That is the point I am getting at.

Jeremy Peat: There is plenty of room for manoeuvre, but it is not necessarily over the aggregate aspects of fiscal policy. There is plenty for room for manoeuvre to set separate corporation tax rates and income tax rates, subject to any constraints that the EU may lay down. There is plenty of scope for having a different allocation of public expenditure on different components. There is certainly choice between going for different regimes on all aspects of taxation. But there will be an overarching constraint of some sort with regard to the aggregate fiscal policy. There was already a great deal of devolution on some taxation and there was a great deal of devolution on micro policies.

Lord McFall of Alcluith: Does this fit in with his comments to Andrew Neil in March, when he said that there is a need for a fiscal stability pact?

Jeremy Peat: The fiscal stability pact would be part of the agreement, as I understand it, between the UK Government, the Bank of England and the Scottish Government as to how the currency union would operate. But within that context, as I said, there is a great deal of ability to vary individual taxes and indeed to operate the public finances independently, subject to an overarching constraint or two as to the overall fiscal position and the sustainability of that position.

The Chairman: That is the crucial point—the latter part of what you were saying.

Jeremy Peat: The sustainability?

The Chairman: Yes.

Jeremy Peat: Yes, but this is the other complexity: no one has mentioned oil yet. You may be coming to that. But if one looks at the present position and allocates, for example, a geographical share of output from that sector to Scotland for GDP purposes and a geographical share of tax revenue to Scotland for its revenue purposes, you get a very interesting picture. If you look historically at how, on that basis of allocation, the public finances of Scotland have varied compared with the UK's, you can see the very great sensitivity to oil prices. Looking forward, there will be great sensitivity to both oil prices and the volumes of oil and gas produced. I am always careful about forecasting this because when I came to Scotland in 1985 to work for the Scottish Government, I was told that one of my first tasks would probably be to deal with the impact of the run-down in North Sea output on Aberdeen and the north-east of Scotland. Well, that was a long time ago. I do not know what output or oil prices are going to be, going forward, but I know how sensitive the Scottish public finances will be to those matters.

The Chairman: Our next session will be on that very issue.

Q537 Lord Hollick: If Scotland votes for independence, the question you just posed of how you divide the assets up becomes absolutely critical. Oil is one thing, but there are other assets and liabilities. In the context of liabilities, one point that Danny Alexander made last week was on the much faster rate of ageing in the Scottish population, which obviously leads to significant additional pension liabilities. As you think about splitting or carving up the cake, what in your view are the key issues and problems that have to be addressed from the point of view of establishing a viable, independent Scotland?

Jeremy Peat: If I could start on that, I would commend to you two papers that we produced in the David Hume Institute. Lord McFall has already quoted from one, *Public Sector Remuneration in Scotland*, which also covers pensions and related issues, with David Bell and Bob Elliott contributing and a number of others including STUC. That is an indication of some of the key issues. The other is our first attempt to look at the allocation of debt and, to an extent, assets, which we produced in March 2012. We tried to identify there a framework within which one can look at the type of issues that you are referring to. But, yes, in addition to the sensitivity to how oil prices and outputs impact on revenues and indeed on the economy more generally, there is the demographic issue. The data there suggest that the dependency ratio in Scotland—the ratio of those in employment to those outwith the normal working age—will be adverse as compared to the rest of the UK over the next 20 years, but again that is dependent on those forecasts being accurate. It also depends on what happens on migration. At the moment, there are constraints on migration which exist from the UK Government. Scotland as an independent nation might be able to have its own policy on migration and might wish to take a different view as to how it could partially offset the risks of an ageing population by attempting to attract a more vigorous, younger group—possibly from those who are coming to Scottish universities in great droves. They might be tempted to stay on and participate constructively. It could be that if one goes down that road, it would lead to another major source of dynamism within Scotland.

Q538 Lord Forsyth of Drumlean: I am aware that we are short of time, Lord Chairman, but could I go back to the lender of last resort and the position of large financial institutions such as the RBS? You said that it was not clear whether the Bank of England would be a lender of last resort to an independent Scotland. I cannot for the life of me imagine why the Bank of England, which the taxpayers in the rest of the United Kingdom stand behind, would want to be a lender of last resort to a foreign country, which is what Scotland would become. For large organisations such as RBS, faced with the choice which you pointed out between being based as a company in the rest of the UK or being based in Scotland—with the likelihood that the costs of raising capital for those institutions based in the rest of the UK would be considerably less than if they were based here in an independent Scotland—why would such large organisations not make that choice? In all the arguments about this being terribly complex, is it not very simple? It is highly unlikely that English taxpayers or those in the rest of the UK would want to be a lender of last resort, or that these large financial institutions would wish to remain headquartered in Scotland, because of the cost of capital.

Jeremy Peat: If I could start off with one point that you made en passant, I do not think it is clear at this stage that the cost of borrowing for Scotland as an independent entity, or for financial institutions in Scotland, would necessarily be significantly higher for a continuing period than in the UK. It all depends, as ever.

Lord Forsyth of Drumlean: So you disagree with the evidence that we got from the Permanent Secretary at the Treasury last week, who said that it would because Scotland would not have had a track record?

Jeremy Peat: I referred to it being over an extended period. I think it will be necessary initially to establish the track record. However, I have looked at the terms and conditions that Standard & Poor's and Moody's apply and they would have to see whether they could, in a relatively short period, establish the credibility of the regime in such a way that its rating was similar or close to that of the UK. Whether that would be achieved and how long it would take for that to be achieved, I do not know. The issue is how they would set out in a whole host of areas in order to establish credibility—and establish a rating that meant that the cost of borrowing was as close to that of the rest of the UK and other AAA-rated economies as it could be. To an extent, the rating of any companies based in Scotland would follow from that, although there are instances where companies can have a higher rating than their country. Some companies retained AAA-rating when the US was downgraded, so there is a link between company rating and country rating but it is not an absolutely firm and fixed link. This is one of the many imponderables.

Yes, there would be scepticism from the outset as to the rating and what the cost of borrowing would be. Yes, there would be uncertainties; I would never disagree with the Permanent Secretary to the Treasury that, at least for the initial period, the tendency would be for the cost of borrowing to be higher. That does not mean that it would be in a sustained period. Scotland would have a GDP per head that was higher than practically every region in the rest of the UK, if oil and gas activity was allocated on a geographical basis. There would have to be a view taken on whether it had policies that were going to lead to higher growth and to a strong economy, going forward, and whether companies within that economy would operate well. All of that will be determined by what happens not just over the next two years but over the next several.

Q539 Lord Tugendhat: Professor Peat, you said that in 1985 you were being asked to look at the implications of the rundown. I can match that in a sense in that I wrote a book about the oil industry in the late 1960s, when the world's official reserves were supposed to last for 20 years. So there is a lesson in that; oil reserves are rather elastic. My question is about whether you think that Scotland might become overly dependent on the oil industry. I ask that in this context—that in an uncertain world, one thing that seems reasonably certain is that North America will have energy self-sufficiency within a reasonably short time. That is going to have a profound effect on the history of international oil prices. Then there is the question of shale gas, not just in England but in other European countries, which will potentially lead to a very significant diversification of gas supplies. In those circumstances, what do you feel would be the nature of the Scottish economy's dependence on oil, accepting your assumptions about what the division of resources would be—which might not be the case?

Professor Charlie Jeffery: I think that you raise a challenging question in a number of ways. First, we do not know what energy production patterns will be and therefore we do not know what the price of the oil produced or the effect on the Scottish budget would be. They all appear to me to be risks that any competent Government would wish to mitigate by taking steps to diversify the economy of Scotland. One obvious area that interconnects with all those areas of oil and shale and fracking and so on is that of renewable energy. Scotland has a lot of wind and a long coast and places where tides get pushed through relatively narrow gaps. That is one area where the current Government, or any Scottish Government, would be looking to boost economic activity both in the production of energy and in the exploitation of power. Jeremy Peat has pointed to other areas. Scotland has outstanding universities, relatively speaking, in the various global league tables that are produced. That offers enormous potential as an export industry in itself and as a means to attract talent to Scotland to help to develop the economy in various ways. But I think that that diversification is an essential point that any future Government of an independent Scotland would have to prioritise.

Q540 Lord Tugendhat: Can I just backtrack? Scotland has a great many assets; it has a great many actual industries and it has potential industries. The point about universities is well taken, and we all know about Silicon Glen. I agree with all that, but oil has loomed very large in the independence debate over the years, yet it seems to me that the independence referendum is coming at a time when the balance of power in the energy world might be shifting in favour of consumers, with the downward pressure on prices, principally because of the extraordinary events in North America. Once North America ceases to become a major importer and becomes an exporter, the effect on energy prices is likely to be downward for quite a long time.

Jeremy Peat: If I could just add a comment or two on that, it is important that the Scottish Government looks at the story on the public finances and the story on the wider economy in the context of different scenarios for the energy future. You have put forward one plausible scenario, with the balance of power shifting for the consumer, with all prices tending to fall and having an adverse effect on revenues and activity. That is certainly a plausible scenario, but I have been in this game long enough to know that there are other plausible scenarios. Given the sensitivity of the public finances to this issue, I would wish there to be another story told, looking at the implications for different sources of revenue with the need to revisit decisions on public expenditure, in the context of alternative views of the world. It is not a matter so much of what happens in the next 12 months as what happens over the next 10 years that really matters. It is very important that Scotland does not become overly dependent on any one sector; we are already seeing imbalances within Scotland, with very low levels of unemployment and a high demand for labour in the north-east, and a very much higher GDP per head there compared with that in the west central belt, for example. That is an imbalance that is difficult to manage at times.

Going forward, I do not think that we should neglect the great possibilities of the oil industry for other territories and other activities. There are huge skills that have been developed and very strong companies that can sell their services and are selling their services globally. So I would look for diversification in using those skills in addition to focusing on the very strong industries that we have within Scotland. There are some very competitive and dynamic Scottish companies, but not enough of them, and there are very successful Scottish companies, and I would look for a means by which several sectors could develop to be as effective and internationally competitive as we are seeing already with one sector. We need that diversification, with an examination of the wider economy and public finances.

Q541 The Chairman: The timescale that you suggest is very interesting—it could be five or 10 years, but it could be a very tricky period, if receipts from oil declined significantly. Would that mean constraints on other areas of public expenditure, if the diversification was not fast enough? Secondly, would you be in favour of an oil fund to build up the public assets for the times at which they were depleted even further?

Jeremy Peat: Those are two difficult questions. I was very much in favour of an oil fund 30 years ago, when the oil fund option would have worked. At the moment, it is difficult to see how funds could be allocated of substance from the existing public finance arrangements for several years to build up a fund. I would not say that it is impossible, but it would involve even tougher choices on aspects of public expenditure than we are facing at the moment. There could be a tough period of years, if one had a very sharp decline in the oil price, leading to a very sharp decline in oil and gas revenues. The figures that I have seen suggest that that would have a significant immediate impact on public finances in the years in which it fell. So we would then be dependent on what any agreement was with the UK authorities as to the fiscal compact, or whatever one has, on whether there is a degree of flexibility to allow for changes over time. Any sharp year-on-year requirements would be extremely difficult, but I would expect, just as the present UK Government are seeking to reach a certain position by 2015 or 2016 or whatever, that there would be a degree of inter-year flexibility. It would certainly make the position much tougher if the oil price fell sharply. It would be much better if the oil price went up again.

The Chairman: Professor Jeffery, I understand that you need to go.

Professor Charlie Jeffery: May I make one comment before I do? It is about the question that has been raised about the fiscal pact, and whether it contains such flexibility to manage short-term volatility. It addresses Lord Forsyth's questions about why the English or the rest of the UK would ever want to offer these services to a foreign country. I think that the answer to your question about the fiscal pact depends on how far the UK will see an independent Scotland as a foreign country. Would it be a foreign country in the same way that Bulgaria or Zimbabwe are, or would it be a different kind of foreign country? It is really a reiteration of my first point about this notion of independence with partnership which the Scottish National Party and others elsewhere have. The question is whether that notion would be reciprocated by the UK Government following a yes vote, on the basis of shared history and so on. My suspicion is that it probably would be reciprocated to an extent, although that is something which we cannot foresee. I do not think that the UK Government are likely to tell us at this stage until they have a yes vote in front of them.

Q542 Lord Tugendhat: Certainly I agree with you that there are gradations of foreignness, and Scotland would not be a foreign country in the same way as Bulgaria. But, with great respect, you are sliding over one difficult point and that is whether the taxpayers would want to stand behind foreigners, however close the foreigners are. After the separation by choice of the Scottish people, would the remaining British taxpayers feel that they should stand behind the people who had separated?

Professor Charlie Jeffery: Very briefly, there is already quite a bit of evidence that many taxpayers, especially in certain parts of England, feel that current arrangements are not as fair as they might be. I cannot imagine that that situation would change in an ameliorative way if Scotland became independent. So while I am saying that some of the notion of close partnership might be reciprocated, I do not think that that would mean an easy ride. I do not think that it would mean a lack of tough negotiations. I do not think there would be a UK Government free to negotiate such arrangements without taking into account public opinion, which would envisage Scotland in a different way if Scotland chose to be independent.

Q543 The Chairman: I do not think that we have time to go into the Barnett formula, but thank you very much for coming, Professor Jeffery. I know that you have been under great time pressure. Mr Peat, do you want to comment on this before we turn to other questions?

Jeremy Peat: I just want to add one last comment. My understanding is that, under the new crisis management which has been established, or is coming to fruition, if England has operational responsibility for the crisis it will be the UK Government that have to make the crucial decision to apply public funds. It is quite interesting as to how the UK Government would determine if a Scottish-based institution was in difficulties and needed support. It would be their decision explicitly as to whether the funds were applied, rather than the Bank of England's. That adds to the interest of the issue.

Q544 Lord Hollick: Mr Peat, you have mentioned on a couple of occasions what we might call the dynamic potential of the Scottish economy. You have referenced the possibility that it might have a different immigration policy, which might bring younger and possibly more entrepreneurial folk into the country. What could an independent Scotland do that it cannot currently do as part of the United Kingdom to promote faster growth and greater entrepreneurial activity in Scotland?

Jeremy Peat: It is a very interesting question. I think that a great many of the levers of microeconomic policy have already been devolved to Scotland at any rate. The question is whether the establishment of an independent Scotland would, first, add some extra powers such as potentially setting rates of corporation tax, a different migration or lower regulation in some areas—whatever there may be. Also, there is the question of whether the mere fact of independence might lead to an inflow of expatriate Scots with capital who might wish to invest in their newly independent country. They could be new dynamism coming in, and there could be other features which would create a different dynamic within Scotland. I have not seen this explored carefully and rigorously and I hope that, as part of the further examination which ESRC will be supporting and others will be doing, some of these issues can be more carefully and rigorously addressed than I could hope to do at the moment. It is a critical question as to whether there are changes, impulses and regimes that would be possible under independence which are not possible now, and whether there would be other changes in the environment that would lead to the potential for a faster growth rate in Scotland than has been the case in recent years.

Q545 Lord McFall of Alcluith: You mentioned the popular view and the popular will. What do you think that this referendum will revolve around? What theme do you think that will be?

Jeremy Peat: I am not qualified to judge on that. I am not a political scientist, as Charlie Jeffery is. Secondly, it is far too early to judge. We have just got a little bit beyond the phoney war, and I think we are now going to get into the evidence-based discussion. I want to lay emphasis on the David Hume Institute and other contacts really enhancing the evidence-based information that is available, transparently, to all people who will be making a decision. We have to spend the next 18 months getting that right, and that is utterly important for getting the right decision, whatever that may be.

The Chairman: We share that view, which is why we are doing this inquiry.

Jeremy Peat: That is why I welcome it.

Q546 Lord Forsyth of Drumlean: Going back to the importance of North Sea oil revenues, Professor Rowthorn from Cambridge gave us some evidence that there is concern as to whether Orkney and Shetland would wish to remain part of an independent Scotland, or whether they would go with the rest of the UK. Depending on how you divide up the oil revenues, they would get about 30% of the revenue, so there is obviously a huge financial incentive for the people of Orkney and Shetland to stay with the rest of the UK. How practical do you think that would be, or how likely is it that they might take that view?

Jeremy Peat: I find it somewhat unlikely that it would happen. When you are talking about higher interest rates in the UK causing problems for Scotland in previous years, I remember that there were people underneath who argued that it was all Edinburgh’s fault. You have this difficulty of geographical differences that emerge. We have enough on our plate looking at the issue of an independent Scotland without going beyond that to whether the Northern Isles would separate as well.

Lord Forsyth of Drumlean: There has been some comment from the political representatives in that part of the world and elsewhere. If the argument runs that Scotland would so much better off with the oil, then for Orkney and Shetland it is squared, is it not?

Jeremy Peat: I can understand that position, and of course Shetland did establish an oil fund, which has been very effective in dealing with issues there. I can understand the issue but, to me, it is not yet on the agenda. I have got enough to do in trying to help analyse the issues that we do have on our agenda without going beyond it at this stage.

Q547 The Chairman: We have covered a lot of issues. In conclusion, are there any other major possible benefits or disadvantages of an economic nature that we have not covered?

Jeremy Peat: I think that you have covered the key ones. We will be looking at some of the macroeconomic and regulatory issues in the first element of our work. We will then look at options for different means of delivering public services of different types, and whether there is more flexibility or a different approach that could be developed. We are then going to look at the energy sector and all of the issues there. We have touched on most of those features. I think that the real unaddressed issue is what could change the dynamics within Scotland, which I would rather was not just a matter of rhetoric but was preferably founded on some consideration of what had happened in other small economies that had been successful and other small economies that had not been successful. We need to learn more from those examples. We need to consider what could be achieved, as Lord Hollick was asking, in wanting to move in that direction. There is plenty on the agenda. We are making some progress and I think that we will continue to do so.

The Chairman: Mr Peat, thank you very much for giving us a very interesting and helpful start to our two days. We are most grateful to you and will look forward with interest to seeing what further work you do on some of these issues. Thank you very much for coming.

Jeremy Peat: Thank you.

Examination of Witness

Professor Alex Kemp, University of Aberdeen

Q548 The Chairman: Professor Kemp, thank you very much for coming and thank you for your very helpful paper, which covered a number of the issues we wanted to explore with you. Perhaps I may start by asking this question: if Scotland became independent, North Sea oil and gas reserves would have to be divided up between Scotland and the rest of the UK, as would many other assets and liabilities. You have suggested that the starting point for the division of North Sea assets should be the median line. Can you tell us the precedent for this and what alternative divisions are conceivable? Why do you refer to the median line as the starting point for those discussions? Are there examples of different divisions in past negotiations on natural resources, or is it mainly the median line?

Professor Alex Kemp: Historically the UK Government and Governments on the other side of the North Sea found favour with the median line. We go a long way back to the 1958 convention on the north continental shelf. That is why I say it is a starting point. It was felt by the UK Government and the neighbouring North Sea countries—Norway, Denmark and so on—that this was a reasonable way to divide up the North Sea. I say "starting point" because it is a negotiation. The starting point in the negotiation is quite likely to be the median line. However, other issues frequently emerge—for example, the status of uninhabited islands. Are they part of the UK or not? Are they just rocks in the sea? The most dramatic example of that was Rockall. In 1972, the UK Government passed the Island of Rockall Act, which stated that henceforth Rockall was part of Inverness-shire. This was to the disbelief of other countries such as Iceland, the Faroes and Denmark, which thought that it was just a rock in the sea. These are examples of where the median line has been disputed. Some time ago in the late 1960s, West Germany disputed the use of the median line between Denmark and the Netherlands, and went to the International Court, which, to the surprise of most at the time, ruled that Germany was getting too small a share of the North Sea from the use of the median line and drew some other lines. The UK has also had disputes with Ireland over the Irish Sea, and with France over the Channel. A lot of the disputes have been to do with little islands and whether they are part of the median line. In the case of Scotland and the rest of the UK, the median-line principle seems relatively straightforward. There are little islands called the Farne Islands, which could cause issues, if you really wanted to go into the minutiae. More seriously, someone could say that there is an existing line just north of Berwick going straight out into the North Sea which is used for dividing Scottish and English civil and criminal law. Some might say we should use that line, but the median line is established for fisheries management purposes and I should have thought that there would not be too much controversy about that.

Q549 Lord Tugendhat: You have had a great deal of experience of the oil industry all over the world. You have seen a variety of different agreements between contiguous territories. That brings me to ask you about the Northern Isles. We have seen evidence from the two MSPs suggesting that they might seek some distinctive constitutional position. On the basis of what you have seen around the world, would you expect the Northern Isles to seek some kind of special dispensation, either within the remaining United Kingdom or within the newly independent Scotland? Given that a considerable proportion of the reserves lie within their general domain, what do you think would be the parameters of the sorts of agreements that would be reached between the Northern Isles and either Scotland or the rest of the UK?

Professor Alex Kemp: It is a nice debating point but it has not been a live issue. I go to Shetland from time to time. I am asked to give advice on some subjects relating to oil. It has not been an issue for a long time. There was such a debate back in the 1970s where

Shetland in particular was expressing some doubt about the wisdom of being part of an independent Scotland. So it is not a live issue at the moment. It is correct that a lot of the reserves in the east Shetland basin are adjacent to Shetland, and are hopefully growing west of Shetland, including west of the Western Isles. Hopefully, they will become quite big. My view is that it is not likely to become a live issue. As far as foreign policies are concerned, there is no good reason to think that Shetland would get a better deal from a London Government than a Scottish one.

Lord Tugendhat: I am not suggesting Shetland would get a better or worse deal; I was wondering whether you felt that it would seek some special deal, either within the newly independent Scotland or within the remaining UK.

Professor Alex Kemp: I repeat the point that it is not a live issue at the moment, but who knows? It is the case that both Shetland and Orkney have their own oil funds, which they set up amid strong opposition from the UK Government and the Scottish Office, as it was then, in the 1970s. Neither was in the least bit enthusiastic that the revenues should be shared by the local governments. They were worried that it could encourage others to think similarly and ask for a share of the revenues as well. It is the case that Shetland, which I know quite well, is conscious of its oil fund and the advantages that it has brought. Of course in more recent years, there have been new developments west of Shetland. The Laggan-Tormore gas will be landed at Sullom Voe. Shetland has requested, and I understand is going to get, some small royalty on that production. Shetland is conscious of all that, but on a greater scale, I am not convinced. There is no evidence of it at the moment, anyway.

Q550 Lord Forsyth of Drumlean: First, I thank you for the excellent paper that you sent to the Committee, which I read last night. I had not appreciated the complexity. We talk about transferring the oil resources according to some line, however it is drawn, but I had not appreciated that there were huge complexities in terms of, for example, the health and safety and regulatory regimes. When I was the health and safety Minister, I did the case studies following the Cullen report on the disaster. At that time, a single case study cost more than £1 million. Reading your paper, you point out that the whole business of the regulatory regime had to be decided and set up. Regarding the licences, you also point out that, if it were a company, you would get a change of control and you could say, "Hang on a second. We need to renegotiate this". I do not know to what extent licences would be up for renegotiation. Obviously, the oil companies would try to take advantage of that. The third thing that struck me from your paper was the complexity of the taxation regime, which goes right back to events which would then be in another jurisdiction. Although you point out that a lot of these operations are run out of Aberdeen and Scotland, I wonder whether you have a view on, or an estimate of, what the cost would be of an independent Scottish Government setting up these regulatory regimes and doing the negotiations, and the possible leakage—an unfortunate phrase—of revenue arising from the fact that everything is being thrown up in the air. Also, do you have a view on the possible consequences, in terms of the safety regime, of having to move to a new regulatory regime? I know that that is a really big question but your paper prompted these thoughts.

Professor Alex Kemp: In the paper I did indeed highlight what we might call transitional problems. There will be transitional problems in relation to the economy but, with respect to North Sea oil and gas, there are certain characteristics of the industry which mean that a lot of attention has to be given to the transition. With regard to licensing, a Scottish Government would have to establish departmental expertise in licensing. To do efficient and effective licensing would require them to be knowledgeable about the historical process involved when licences were awarded and when field development plans were approved and all the gradations pertaining to that, so that they would be in a position to assess how well the companies were doing in relation to their policies, exploration programmes, development plans, et cetera. That would require the transfer of a lot of data and acquisition of knowledge, which currently resides in the Department of Energy. It is true that physically quite a bit of it, but not all, is in Aberdeen.

On tax, the expertise is currently with a specialist division of HMRC. Again, the issue is that, to assess the tax position of all the licensees, you need a knowledge of history because it is all about fields being explored for development, hopefully over a long period. There will be various tax allowances that will be carried forward to assess how much tax we should be paying this year and next year. Again, there will be a need to acquire knowledge and set up a specialist unit. To be effective, there would need to be the transfer of a lot of relevant data from HMRC in London to Scotland. With respect to the HSE, again we have a UK agency policy based on the safety case. But again, in order to assess policies, expertise would have to be developed by some body corresponding to the Health and Safety Executive. These are transitional problems but of course they can be overcome—I am not disputing that. I am just saying that, if we are looking at the oil and gas sector, my conclusion, if independence comes about, is that investors and Government would have to think about it much more.

In respect of your question about whether companies would seek to renegotiate licences, the answer is that they might. The obvious thing for a Scottish Government to do with existing licences which still had 20 years to go would be to honour them in order to save a lot of disruption. For new licensing, they would develop their own policies. Those are the particular transitional issues that I wanted to raise with you.

Q551 Lord Forsyth of Drumlean: Just to press you on that, I know nothing about how these licences are written, but can they just be transferred? They are agreements between two parties—the oil companies and the British Government.

Professor Alex Kemp: Yes.

Lord Forsyth of Drumlean: If the Government say, "Well, actually, we're moving them to somebody else"—the Scottish Government—does that not trigger the possibility of renegotiation of the licences? The specific question I asked was about the cost of doing this—not just the cost to the taxpayer, which will be in Scotland, but to the companies concerned. They will have to deal with a new regulator, which may have a different view on what the appropriate safety case regime will be, and there will be all the uncertainty. Have you estimated what the costs might be, as well as the opportunity costs? They might say, "Do you know what? The North Sea is such a shambles at the moment that we don't know what's happening. We'll go somewhere else." Are there opportunity costs as well?

Professor Alex Kemp: There will be some costs for the investors. For tax purposes, they will have to establish central management and control—that is the nice phrase used—within the country where the tax is being levied. They would have to establish that in Scotland to ensure that a Scottish Government could tax them effectively. With regard to all the other licensing issues, it is indeed conceivable that investors would want to reopen some clauses and ideas. Again, if a Scottish Government had, let us say, any sense, they would aim to prevent that big disruption. So these are the key points.

Q552 Lord Hollick: I have two questions. Perhaps you can help us with understanding the importance of the oil sector to the Scottish economy in terms of investment and direct and indirect employment today. Looking to the future, can you give us your assessment of how current extraction rates will decline and over what period of time? Having regard to some new technologies that have been developed in United States to extract more, at what point in your estimation do the extraction rates fall to a level when it becomes economically problematic?

Professor Alex Kemp: On the importance of oil and gas to the Scottish economy, the most readily available data relate to employment—I have the figures for 2010. Direct and indirect means the oil companies plus all the supplying team, which is 110,000. Induced means when all the people directly and indirectly employed spend money in pubs and hotels and so on, which is 41,000. Exports from the oil and gas are 45,000. So for 2010 it is 196,000. It has probably grown a little since then because there has been very high investment in the past year, this year and next year. So that is very substantial. In parentheses, I should say that the oil and gas supply chain has been a big success over the last number of years when other sectors of the Scottish economy have not been performing well. To give a little history, the big success has been that the oil and gas cluster has become internationally competitive. Subsea technology developed in the North Sea is now exported to a large number of countries, such as offshore in west Africa and the Gulf of Mexico and onshore Russia, Azerbaijan and so forth. At the moment, of the turnover of the Scottish oil and gas cluster, which is the supply chain, about 45% is now exports.

To come to your other question about the North Sea declining, the new paper that we are publishing shortly, which I managed to get into the memorandum for you, shows that oil production will come up a bit in the next few years—it has been very low recently—but will then go into terminal decline, although it will last a long time. Our own modelling shows that some fields will last until 2050. From the point of view of the supply chain, there is good reason to think that the export growth will continue. We have good data collected since 1997. There has been continuous growth in export turnover for quite some time. I think we have good grounds to believe that, when the North Sea does go down, there will be some replacement for all that by further growth in export markets. A long time ago—as you said, I have been studying this industry for a long time—it was thought that when the North Sea started to go down, the big multinationals would withdraw to other areas. I do not just mean the oil companies but the big supply companies, such as Halliburton and so forth. They will withdraw to other areas that are growing faster. That has not happened. The interesting point is that the supply chain based in the north-east of Scotland, but including some in the central belt, has continued to have headquarter-type operations, which service other markets such as west Africa, which has grown strongly, Brazil and the Gulf of Mexico. Why is that? The answer is that there is a big cluster now. The cluster has reached a critical mass, so the ancillary services that Halliburton and its equivalents would need are around them as well. As long as there is some activity in the North Sea, albeit in decline, there is reason to believe that, because of the expertise in the cluster, exports will continue to flourish.

Lord Hollick: So by 2050, the oil and gas extraction will be economically low.

Professor Alex Kemp: Very small.

Lord Hollick: But the industries that have been created could well have a life after that because of the cluster effect you describe.

Professor Alex Kemp: Well, 2050 is rather optimistic, but if we are talking about 2020 or 2030, I would be happy to say that we will still have quite a big, active supply chain. There is a big debate about how the world oil and gas industry will grow over such a long period. Some think that it will continue to grow to 2050, but certainly it will continue to 2020 and 2030 or so, and that gives opportunities for the supply chain. The reason why the supply chain in the north-east of Scotland has become internationally competitive is that they brought in subsea technologies at an early stage. They developed these techniques at quite an early stage, and now subsea is becoming common all over the world. At Aberdeen airport you find people flying off to Angola, Nigeria, the Gulf of Mexico and Brazil and nobody thinks anything about it. That kind of thing could continue for, let us say, 20 years, but I am not sure about 2050.

Q553 Lord McFall of Alcluith: Professor Kemp, you mentioned the complexity of the tax charges on capital allowances. Notwithstanding that, could you give us an idea of the net tax revenues from oil over the next five to 10 years?

Professor Alex Kemp: In my memorandum, I had a chart where I gave the results of studies that we have done in the past to assess the hypothetical shares attributable to the Scottish sector using the median line. You can see that they would have been very big in the first few years in the 1980s. We are talking about very profitable fields and big tax revenues as well. In more recent years, they have fluctuated a lot. That is the obvious feature. They have gone up and down in relation to changes in tax rates but also in oil prices and allowances for tax. Right now we have several very big fields being developed. They will get capital allowances on a 100% first-year basis. That will reduce taxable income for the next two to three years.

I did two studies in the past. One was financed by the *Economist*, the other by the Scottish Government. To do a study that produces results of which I could feel proud requires quite a lot of intricate work. I can explain it. We have a very good field-based model. But to get the tax payments, you need other miscellaneous costs, such as exploration appraisal costs, overheads that were not directly attributable to the field but are not tax-deductible, like R&D costs—a lot of things like that where you would have to allocate them between the Scottish sector and the rest of the UK. A lot of judgment is involved. When we did the historic, we had the comfort of being able to check against the UK-published tax revenues. I was comfortable about the results because we modelled separately and checked against the UK. Going forward, we will not have that check. The budget document does indeed give some round numbers for five years. However, I have said that without doing a lot of intricate work which is really quite time-consuming I can make a guesstimate that for the Scottish sector it could range annually between £5 billion and £10 billion per year for the next decade. Factors that will determine whether it is up to £10 billion or down to £5 billion are the behaviour of the oil price and the behaviour of production. The past two years have been very bad, but we are fairly confident that oil production will come up again. It will take a year or two. Other factors are tax rate and tax allowances. As you probably know, there have been quite a few changes to tax allowances over the past couple of years following the increase in the Budget in 2011. All those affect revenues, so for Scotland I am prepared to say between £5 billion to £10 billion per year for the next 10 years.

Q554 Lord McFall of Alcluith: What credibility do you give to the contribution to our Committee that says that Centrica, which owns British Gas, has claimed that a mere 14% of North Sea oil and gas areas are located in Scottish waters, with the rest falling in English, Norwegian and Dutch territories?

Professor Alex Kemp: One investor was particularly looking for gas and to have their own gas. Prospectively the UK for some years now has become more oil-prone than gas-prone. I have a chart in my memorandum showing prospective gas and oil production, and gas production goes down quite steeply. If you are looking for gas, the UK compared to Norway is less prospective as things stand, unless you are prepared to go west of Shetland, as some investors are—but some are not so keen, because it is very high cost. The oil has been the driver in recent years and in our modelling it will be the driver for the next few years. Of course, there will be gas fields, but in terms of size, they are not quite so big. Just to add to that, one sobering fact is that in the southern gas basin, which was the first region developed, in the first nine months of the year there was no exploration.

Q555 Lord Forsyth of Drumlean: Just on a point of information—and this is really complicated—the number you gave before Lord McFall's question is a net number. For a Scottish Government in an independent Scotland with all these oil fields, it is comparatively easy to make an estimate of how many barrels of oil come out and the oil prices. That is the number that is often used in public debate, but is there a number that represents the liabilities in terms of the tax regime and other liabilities that occur? Is there a global number? You are getting the asset of the North Sea oil resources. Yes, they may provide a revenue stream based on the oil price and your estimate of the likely extraction rates, but on the other side of the balance sheet there is another number, which is what you have to pay back in tax release to the companies, which go back a long way—as well as clean-up and other costs. Can you give us a global number for what that is? What is on the liability side? Everybody always looks for the revenue.

Professor Alex Kemp: The costs are very high, there is no question about that. Over the last 10 years, the oil price has gone up but the costs have more than doubled over the past eight years. For a new field development, on average we are talking about development costs of $19 per barrel and lifetime operating costs of $13 per barrel. That gives you a flavour; that is the average, but the range can go very much higher than that. Right now this is having an effect. The OBR in Budget 2011 estimated tax revenues of £13.4 billion for the whole of the UK. This year it had to downgrade the estimate to £11.2 billion. The price had not come down. New investment is going in now, in very expensive fields west of Shetland. The allowances are provided 100% the first year—that means, right away. The taxable base goes down because of that. So there was a big unexpected short-term reduction because, first, that production went down. We now have quite a few fields that are very old; one-third of the platforms are more than 30 years old, and we have had quite a few unplanned shut-downs because of that and the ageing infrastructure. These were the two factors that led the OBR to reduce its estimate for 2011-12 by such a big magnitude. So you are right that the costs are very high, and we should not be lured by the price of $100 per barrel.

Q556 Lord Levene of Portsoken: Given the volatility of net tax revenues, this would translate into volatility in the budget deficit, at least in the early years. What does that imply for the budgetary process? Is the main source of the volatility the oil price volatility? Would you expect that to make fiscal policy more difficult? Would you argue in favour of a non-oil fiscal target for the future?

Professor Alex Kemp: As I said, the volatility recently has been due to the oil price fluctuation. Secondly, on allowances for costs, at the moment a number of fields are being developed at the same time. There is coincidental development of a number of fields. That reduces the tax base a lot. It is just part of how things are in the oil industry; if a company makes a good discovery it will develop it when it feels that it is most appropriate, and others may also make discoveries—and if they develop at the same time, the costs are higher. By the way, there is a cost push as well; there is a big element of that right now.

From the point of view of the Government, I have argued for many years that it is not very wise, and not very good economics, to rely on oil revenues for normal budgetary purposes. That applies to a UK Government or a Scottish one. That is partly because of the volatility. The chart shows that the numbers can change a lot in a very short time. But it is also because it is conceptually unsound. Oil revenues are different from income tax, VAT and national insurance, because they come from the depletion of a natural resource that is non-renewable. Those reserves are part of your capital stock—you are rapidly consuming your capital, so you should ensure that the net profits and the tax on these profits are invested and not consumed. For a normal budget, that is what normally happens. We had a big debate about that in the late 1970s, although the debate was not really very scientific because, although the idea of an oil fund had some merit, it would have enabled all the spending departments to go and spend some more. The idea is that you do not do that. You put it in a fund to ensure that the capital stock of the nation as a whole is maintained. You can invest the fund and you can have a big party with that—you can have permanent consumption out of that. But consuming your capital is not good economics anyway, although most Governments have not appreciated that.

Q557 Lord Levene of Portsoken: Can I just try to understand that? You said initially that when new developments were going on you would expect the revenue to decrease.

Professor Alex Kemp: Other things being equal, yes.

Lord Levene of Portsoken: Is that because the companies would be spending on that development and accruing less, expecting it to come in at a future date?

Professor Alex Kemp: Yes, in the North Sea system, if you spend £100 this year, you will get a tax allowance right away. It is not spread over 10 years. At the moment we have five big fields being developed, just by chance. There is no good reason why five are happening at the same time. So these tax allowances will be very big this year, next year and the year after, and even though the oil price is $110 it will still have an effect.

Lord Levene of Portsoken: So the more attractive you make it for the industry to come in on a tax basis, the less you can expect to earn during the period.

Professor Alex Kemp: You will get a payback after that.

Lord Levene of Portsoken: But in the immediate term, you will suffer for it.

Professor Alex Kemp: Yes.

Q558 The Chairman: You touched on the oil fund, so I come on to that. You probably heard what Mr Peat said earlier about the prospects for an oil fund. I suspect that he was taking a political judgment that, given the likely heavy public expenditure issues that the Government face, they would not want to see a diminution of oil revenues during that period, which an oil fund, in the short term, at least for the next five years, would create. Do you not think that for all the theoretical merits of the fund, which you have put forward and which I fully understand, that is the likely practical implication and result: that an oil fund would be rejected, certainly in the near future, for up to 10 years? Have the Scottish Government given any indication what their policy would be on that?

Professor Alex Kemp: Well, first, the reason that I introduced a nice paper in 2009 about the concept of an oil fund is that it was nicer in Britain. That is one thing. If you are a Government with a budget problem, that is a different thing. I do not have specialist knowledge of the overall British position, but I read what is publicly available. In the current and likely circumstances, it would be difficult for a Scottish Government to hypothecate away all the oil revenues into a separate fund. I can well see that. That is exactly what happened in 1978 and 1979. We had a debate about that but the Treasury said, "No, we need the money to reduce the public sector borrowing requirement, pay back debts," and all that. So we did not actually do well out of the oil revenues when they were used. Of course, it is a matter of judgment, but when we had huge revenues, the money was used to help public consumption at a time of very high unemployment. That is fine as a concept, but from the point of view of maintaining the capital stock of the nation, it was not.

The ONS produces every year what it calls an environmental account. It recently published one. It has what it calls an oil and gas monthly balance sheet. That says, "You have produced the oil now, so the reserves are down: what is the loss of value net of all the costs and everything?" In 2010, the last year for which it has data, it put the loss of value on the balance sheet at £11.6 billion. That is the concept. In practical reality, it is very tempting for a Government to dip into this. In some countries, they provide legislative constraints on that. Alaska has a permanent fund. It does not put all its oil revenues into it, only 45% of bonus bids and royalties, so by no means the whole lot, but it is made quite clear that those moneys will not be available for the government budget and are invested in a portfolio of assets. The income comes back and, every Christmas, a permanent resident of Alaska gets a cheque.

The Chairman: I understand the advantages, but have not the Scottish Government made pronouncements on what they would do if they were independent on the issue of an oil fund?

Professor Alex Kemp: They have certainly made a clear statement that they would establish one, yes. They produced a substantive paper in July 2009 on the concept and their intention.

The Chairman: So, looking ahead, it is not really an issue that we should take into account in our calculations and our expectation of the cost.

Professor Alex Kemp: Well, I cannot say what they will do, but they have repeatedly said that they have serious intentions of setting one up.

Q559 Lord Forsyth of Drumlean: In your very excellent paper, you make the case for the oil fund. That may well have been a good idea back in 1978 but now, given the budgetary position, for the Scottish Government to set up an oil fund is a bit like somebody who is running up an overdraft wanting to set up a pension fund. All you do is make your overdraft larger. You make very convincingly the economic case that you are in effect consuming capital assets. What I cannot get my head round is that, given that an independent Scotland will have to take a share of the national debt, and given that the national debt at the start of this Parliament was about £1 trillion—everybody talks about the budget deficit, but the debt by the end of the Parliament will have increased by nearly 50% to £1.5 trillion, so the national debt will have gone up by £500 billion—why would you want to use the resources, even if you had the spare capacity, to put them in an oil fund rather than to reduce the overall level of indebtedness of the country, which would have the same effect, according to your argument, of improving the balance sheet of the country? I cannot understand why a Scottish Government would want to say, "Here is an oil fund", when they would be faced with a huge part of what is a growing national debt, which neither Government, on either side of the border, appear to be able to prevent continuing to grow.

Professor Alex Kemp: I am quite aware of all these temptations. The emphasis on debt that you made reminds me of the argument used by the Treasury. I remember Nigel Lawson talking about it. We are talking about the very early 1980s, so there was a very big public sector borrowing requirement. We had very big oil revenues. He argued that the best way to use them was to reduce the public sector borrowing requirement. That, in turn, would reduce interest rates and encourage investment, and that would mean future generations benefited. That was the argument in a nutshell. As a statement, it seemed quite reasonable. The only thing was that it did not quite happen. Investment did not go really up; it was public consumption that went up, for a good reason—we had very high unemployment. The danger is, if you do not do something like that, it is very easy to use the revenues from the oil for what you might call normal budget purposes such as debt reduction, rather than take more painful decisions, which would be moderating public expenditure or increasing other taxes. Taxing the oil industry from a political point of view is often easier than having a decline in public expenditure or increasing other taxes.

Q560 The Chairman: Perhaps I may come back to costs, specifically the costs of decommissioning the oil rigs. I think that you have suggested that that could come to around £30 billion over coming the years. If Scotland were to choose to become independent, would it pay for that cost, what are the plans to create provision for it and are there other costs, such as tax losses, that would be carried forward and set against other businesses?

Professor Alex Kemp: The decommissioning costs are indeed likely to be £30 billion. We are producing a new paper in about two weeks, and we are looking at over £30 billion over the next 30 years. The obligation is on the oil company licensees; they are the ones that have to do the work and pay for it. It is not any Government directly. However, all the costs, like any other legitimate business costs, are deductible against the income of the companies. That is how it works. At the moment in the tax system, rather more than 50% of the costs would fall on Governments in the form of net tax reductions to the companies. It is quite a lot of money and it comes when the income from the field in question has stopped. There are complicated rules for dealing with that. The UK Government are very worried that companies could go bankrupt, renege or disappear, so there is joint and several liability. With the special petroleum revenue tax, you claw back the decommissioning losses against the tax that you have paid in previous years. On these big oil fields that the petroleum revenue tax refers to, you can claw back for quite a few years. For corporation tax, you can set it against any other income that you have now, but there is a provision to claw back the losses that were incurred until 2002. In brief, all these costs are tax-deductible. Averaging out, rather more than 50% will result in net tax reductions to the Government. That is how it works. It is quite complicated in practice. One complication has been pointed out: if Scotland became independent some years from now and wanted to claw back corporation tax until 2002—that is before independence—that would be quite a complicated thing to resolve.

Q561 The Chairman: That is exactly the supplementary question that I was going to ask you. It would be an extraordinarily complicated issue to decide how to share that out between an independent Scottish Government and the UK Government, given that that would straddle both the period when Scotland was part of the United Kingdom and the period afterwards.

Professor Alex Kemp: In practice, how to deal with that might have to be part of an agreement. If fields were transferred from the UK Government to the Scottish Government and then decommissioning came some time later, clawing back against the period when it came under the UK Government would be very difficult. Would they have the books? I guess that it would have to be part of an agreement. That just shows the complexities.

The Chairman: The only thing that this Committee could flag up is that this is a big issue because there are big sums involved.

Professor Alex Kemp: Quite big sums would be involved, yes, spread over a long time. When we talk about £30-odd billion, we are modelling for the next 30 years.

Q562 Lord Forsyth of Drumlean: Very quickly on that point, Alex Salmond has said publicly that the costs of decommissioning would have to be met by the UK Government, but on your analysis that is not something that should be delivered because the oil companies would be operating in an independent Scotland and would expect these reliefs. If the Scottish Government were not going to pay these costs, they would have to remove the reliefs, which would be to the disadvantage of the oil companies. Would this not create great uncertainty for the oil companies in relation to investment?

Professor Alex Kemp: The idea of removing the reliefs would be very alarming. In the 2011 Budget the UK Government increased the supplementary charge from 20% to 32% so it is a profit tax. However, you will not increase to 32% the rate at which you get relief for the commissioning. That sounded big alarm bells and the result was a big debate. The most recent position on that is that the UK Government have seen the merit of making a change like that and have issued a discussion paper about giving guaranteed certainty on decommissioning relief. There is a Treasury consultation paper that is live right now. A Scottish Government, if they were wise, would have to honour that, otherwise there would be a big negative effect on investment sentiment.

Q563 Lord Tugendhat: As I understand it, Professor Kemp, an independent Scotland would have a trade deficit with the rest of the UK. Would you see oil exports as being directed primarily at the rest of the UK in order to balance that deficit, or being directed elsewhere? If elsewhere, given the moves towards self-sufficiency in North America, and given the continued pressure from Russia to export oil because its economy is so dependent on it, where would you anticipate the exports going?

Professor Alex Kemp: From the point of view of the balance of trade, oil exports would be a big plus for the Scottish economy. If Scotland were part of the EU, there would be an obligation not to discriminate against EU partners on exports. It would depend on the open market as far as Europe was concerned. One point is worth bearing in mind. Although it is a big plus for Scotland, it would help the rest of the UK as well. If Scotland were in the sterling area, it would help sterling as well, as there would be a need to acquire sterling to buy the oil.

The Chairman: Professor Kemp, thank you very much indeed. It has been a most helpful discussion and we have benefited greatly from your expertise and your very illuminating paper. I am most grateful.

Examination of Witness

Rt Hon Alistair Darling MP

Q564 The Chairman: Mr Darling, thank you very much indeed for coming. You will be familiar with all the issues that we propose to discuss with you. I think that you have seen the evidence that was given to this Committee last week by a successor of yours—and mine, as it happens—Danny Alexander. There were a number of issues there that we wish to explore with you. I was going to ask if you wanted to make an opening statement, but instead I will just give you the question that will enable you to do so. On what economic grounds—we are focusing purely on economics—do you oppose Scottish independence?

Alistair Darling MP: Lord MacGregor, I have read Danny Alexander's evidence, as you would expect. Perhaps I should at the outset explain that, in addition to being the Member of Parliament for Edinburgh South West, I think that I am here principally because I am chair of the Better Together campaign, which was set up to persuade people in Scotland that we are better together and stronger as a United Kingdom. I am a director of that company, as my entry in the *Register of Members' Financial Interests* discloses. I should probably draw that to the attention of the Committee.

Turning to economics, my position is not that Scotland could not go it alone. Most countries could go it alone. It would need some adjustment. As we have just been hearing, the Scottish economy would be very dependent on a very volatile revenue stream from North Sea oil. However, I am not arguing that we could not do it. My argument is the other way round. We are better off together because of the strength of the United Kingdom, its ability to share risks and the fact that it is by far the largest single market—as well as the importance of the cultural and emotional ties, and the influence that the UK as a whole brings to the European Union, the United Nations, the IMF and so on. My argument is a positive one.

In relation to economics, my concern—and I think that this is a theme that the Committee has examined in its hearings—relates to key issues. For example, if we voted to become independent, where would that leave us vis-à-vis the European Union? You can see from this morning's newspapers that in Scotland this is a very live issue. It would appear that the nationalists simply do not know the answer.

The question of currency is very important to us. Would we be part of sterling? If we joined the European Union, would we be required to join the euro? Equally, there are issues that we may want to come back to in relation to the supervision of banking. This is a very live issue in Scotland because of the problems that Scottish banks got into. All these are issues on which one cannot help but wonder, if one looks at all the problems and uncertainties, why on earth you would be doing this, because you are swapping a set of certainties—even though some are certainties you may not be very happy with and may want to change—for something around which there is a great deal of uncertainty.

This is not just my view. Professor John Kay told a conference here in Edinburgh in July that even if we voted for independence in two years' time, it might take four or five years of negotiations, which in itself would be unsettling for a lot of Scottish businesses. So my argument is that we are better together and I think that there is something of an onus on those who advocate a separate and different course of action to say why—although I understand that you will be lucky to find somebody who will come and speak to you on that subject.

Q565 Lord Levene of Portsoken: Alistair, good morning. You mentioned currency just now. The SNP has said that an independent Scotland would continue to use sterling. What do you think would be the best currency option for an independent Scotland from a Scottish perspective?

Alistair Darling MP: My best option is as now. The pound is ours and the central bank is ours. You have three options if you choose independence. One is to have your own currency, but it would be a very brave country to set out on that course at the present time. The other is to use sterling, rather like Panama uses the dollar. That was the nationalists' position between January and the end of February this year. Their position as I understand it at the moment is that an independent Scotland would seek to enter into a currency union with the rest of the UK.

There is one question that arises before all that. If you are going to share a currency with what would then be a foreign country, at some point surely you will need to ask that country whether it wants to enter into an agreement with you. As you know, the question of sharing our currency is of live political interest, usually vis-à-vis the euro. If you were going to enter into a currency union, first, it is inconceivable that either side would agree to it without having something written down. In other words, there would be rules, similar to the sort of thing that the eurozone is talking about at the moment. I say that because Alex Salmond said recently in Chicago—although I do not think that he shared this thought with us back here—that he did not think that there would have to be a written system of rules, which would give him room for manoeuvre. Knowing him, I can see why he might want that room for manoeuvre. However, on any view, and if you look at the eurozone model, which is the only working model we can look at the moment, things would have to be written down.

One thing that would flow from this is that, if you are in a currency union, both sides would have to agree to each other's budgets. So we in Scotland would be in the absurd situation of having to submit our budget to another, bigger country for approval. As I said before, that is not freedom. That is not giving you more latitude than you have at the moment. If you look at the things that would also come with a single currency, you would have to have an agreement in relation to the central bank. In effect, you would have to have a banking union rather like the one they are developing in the eurozone. So what you are creating is a whole new paraphernalia that does not exist at the moment.

So my key objection to it is that at the moment we are part of the UK, but under the new system you would have to get someone in effect to approve your budget every year. If your whole argument—the nationalists' argument—is that we are being held back, under this arrangement you would be shackling yourself to a system under which you could not move very far with someone else having to agree to it.

Q566 Lord Levene of Portsoken: You explained exactly the perspective from the Scots' point of view. But if you were looking at this from the other side of the table, would the rest of the UK be better off if Scotland did not maintain sterling?

Alistair Darling MP: You are asking a question that has never been put to the rest of the UK. If Scotland voted to become independent, there would be problems if another country started to use your currency but you had no control whatever over what it was up to. At the moment the two economies are fairly close together, but if Scotland were to go on a radically different path—if its borrowing were to increase—it would bother the rest of the UK, which issues the currency, that another country was doing something that it found difficult. You cannot stop someone using your currency, as we know. I do not think that the eurozone is very happy that Montenegro uses the euro, but, frankly, does it matter with Montenegro? Scotland is rather more sophisticated, so I think that it would matter.

I think that if this were to come to pass—and this is the publicly stated position of the nationalists at the moment, and has been since March of this year, so we will take it at face value—they would favour some sort of framework. I would have thought that in the circumstances, having rules to govern these things is far better than leaving things to chance.

Lord Levene of Portsoken: It takes two to tango. The other party could say, "We do not really want you to do this, so you have to go and do your own thing".

Alistair Darling MP: I do not think that you could stop another country using your currency. Frankly, it would be in the interests of both countries to have some rules and regulations. What I do not think they would agree to is a formal currency union without anything being written down, when there would be no checks and controls. Indeed, if you look at what is happening in the eurozone, that is how they started off. Then they had the stability and growth pact, and it was actually France and Germany that drove a coach and horses through that, which demonstrates a rather different point about who calls the shots in Europe. They are now moving to a very rigid system of budgetary approval, controls and so on. That is the model that is around and that is where you would end up. That is why I cannot for the life of me see why, if your whole thesis is that the rest of the UK is holding us back, you would enter a formal legal mechanism that locks you into a policy that another country has to agree to.

Lord Levene of Portsoken: You said at the outset that you did not really see why anybody would want to do this in the first place.

Alistair Darling MP: I do not see it. The argument they are running at the moment is that everything will change, but nothing will change. Whenever you raise any questions, the response is, "Don't worry, that will all get sorted". Your question would be better put to a nationalist—if you can find one.

Q567 Lord Tugendhat: Can I put a question to you that I put earlier this morning about the direction of travel? The markets gave the eurozone a good deal of slack in the early stages because they believed that this was an irreversible arrangement leading to a closer political union. People made all kinds of judgments based on that—and it has now been called into question. In the case of Scotland and the rest of the UK, this fiscal pact, currency union or whatever would be formed after a separation, so the direction of travel would be in the opposite direction. It would be an agreement between two countries that had just separated rather than a group of countries that were coming together. Therefore, there would be great difficulty from the outset in gaining credibility of the markets for the durability of this arrangement. It would be seen not as a step towards closer union, which the eurozone was, but as a way station towards some further element of separation.

Alistair Darling MP: Apart from death and taxes, as has often been said, nothing is certain. Trying to predict what will happen at the moment is very difficult. Your starting point is right, of course. The whole concept of the common currency was ever increasing economic and then political union. That is certainly where the single currency takes you, whereas this has been constructed to achieve precisely the opposite. I would argue that you may start off that way, but sooner or later, with the pact that you would have to enter into, you will have increasing economic and political co-operation, which ultimately will take you to economic and political union. Again, the question is, "Why have you gone through all this trauma precisely to end up where you started?"

There is an added complication. I mentioned the policy changes in relation to currency. We do not know the answer to this, but if Scotland had to reapply to get into the Europe Union and if one of the conditions was that you had to sign up to the eurozone, you would have the odd situation that you had signed up for a sterling currency union but at the same time within whatever timescale, you were also bound to enter the euro. That is why the whole question of where Scotland stands vis-à-vis the euro is critically important, because I suspect that that would have a great deal of bearing about what you did about the rest of the currency. There is an example here of two massive unknowns being imposed at a time of huge economic uncertainty.

The last point that I would make is that you are right that, when the euro was launched in 1999, all the problems that we see today were known about and were talked about. If you look at the then British Government's critique on the euro, published in 2003, you will see that the Treasury identified all the problems that have now come up. On any view, if Scotland voted to become independent in 2014, the current economic turbulence is not going to be resolved. My guess is that the legacy of what has happened over the past four years will be in people's minds and in the markets' minds for the next 20 or 30 years. You are not launching this ship in calm, untroubled waters. You are launching this ship in deeply turbulent conditions. I do not have an answer to this because I am not advocating it, but I am saying, as a practical person with some experience in what happens when you try to fix things in the middle of the storm, it is not a happy place to be doing it, especially when you do not actually seem to know what you are doing.

Q568 Lord McFall of Alcluith: You mentioned the Alex Salmond's Chicago speech and room for manoeuvre. Jeremy Peat from the David Hume Institute said that there could be quite a high degree of room for manoeuvre with different corporation tax rates under a fiscal pact. Could you give us your view on that? Do think that there will be?

Alistair Darling MP: The point of having a pact is that you would have to have various levels of agreement. A simple one would be that you had to look at each other's budgets. The next step is that you would have to agree to them. You might—as you are seeing within the eurozone just now, where they are starting to try to bring together tax rates, which is controversial, but that is the way they are going—say that you are not going to agree to something if you deviate too far in relation to one tax or another. It all depends on what is in this agreement. Part of the problem is that we will be voting in this referendum in advance, possibly, of knowing what these agreements will be, because they will only come along after the event.

It is increasingly obvious that no thinking has gone into any of these things until comparatively recently. The nationalist Government were completely taken aback when they knew they were going to be confronted by a referendum. Like many of us, they thought that it would never happen. On an issue like this, we will not know when we go to the polls, presumably, in the autumn of 2014, what the fiscal pact will actually look like or what any agreement might be. The answer to your question and the point that Jeremy Peat was making is that there are a lot of unknowns, and we will not know them until after the event, which is a pity.

Q569 The Chairman: But would you not agree that it is important to classify and list what the unknowns are?

Alistair Darling MP: Yes. It is like anything else in life. You are taking a decision that will affect the rest of your life and this one is irrevocable—we are talking about the next maybe 300 years. Some things you do know about or you can get the best possible advice on—for example, our position vis-à-vis Europe. I hope now that we will get some clarity in relation to that. But this is something that has to be negotiated.

I am not here to speculate about what is going to happen in the general election in 2015; we do not know what Government will be around at that time or the complexion of that Government. It will almost certainly be different from the one that is around at the moment. We will not know those things any more than after 2016 we will know what the Scottish Government look like. All you can do is to say, "Look, if you narrow down these things, what is more likely than not?" I keep coming back to this point. There is no way that there will be no strings attached. Think about it: why on earth would the other side, assuming they are willing to agree to this, basically write a blank cheque? We would not do it for them and they would not do it for us.

Q570 Lord Hollick: I am afraid that I am going to continue the journey into the unknown. Two things: as you said, there is a live issue around the application that Scotland would have to make to join the European Union. What in your view are the key economic issues that would arise out of that process? Secondly—you have already referenced this—Scotland has a very important financial sector. Two of its largest banks were casualties, as you know from personal experience, of the great crisis. How would you see regulation going forward in an independent Scotland and who would be the lender of last resort? Who would pick up the tab to ensure that Scotland's financial community and its major financial institutions did not simply fall over?

Alistair Darling MP: Let me answer the second question first, if I may. Scotland would need to have some sort of arrangement, either having its own central bank or presumably borrowing the one that was in the rest of the UK. The thing about the Bank of England is that people think that it has unlimited supplies; if the Government need money it says, "There you are. We can help you out". It is not quite like that. The Bank of England is largely funded by the UK Treasury. Its balance sheet has gone from about £100 billion four years ago to £400 billion now. How is it able to do that? Basically because the UK Government stand behind it and for as long as the world believes that the UK Government are credible, that is fine and you can do that. That was important.

I can give you an example. If you look at the total support given to RBS—the decisions taken that brought that bank to its knees were taken in Edinburgh, not anywhere else—the total cost to the UK Government was about 21% of GDP. The comparable figure for Scotland was 211%. That gives you some idea of how important it is to have a central bank that is bigger. The night that I had to bail out RBS, I was conscious of the fact that its balance sheet was just about the same size as the UK balance sheet for GDP at that time. I could do it, and I did it sufficiently quickly, before people had a chance to think about it, and it worked. The

Irish Central Bank tried to do the same to guarantee its banks and people said, "Hold on. You are a fraction of their size. We do not believe you", and look what happened. A similar sort of thing happened in Iceland. You need a central bank. If there were to be some sort of arrangement with the Bank of England, we would presumably say, "Okay, we're guaranteeing the Scottish banks, so someone needs to guarantee that payment to us", in the same way that currently the UK Government guarantee the Bank of England. They would either have to rely on a guarantee from the Scottish Government, in which case the question arises, "Have you got the money if we call this guarantee?" or we would have to require some additional funding or insurance that would impact on the ability of RBS, that part of Lloyds still operating here and so forth to do that.

Those are the issues as I see them. This complicates the whole thing and this is why this is not just an academic debate: it is very real to us. First, in relation to the banks there is the whole question of the banking union and how that will impact on Scotland. If you step back from that, the prior question is whether we would be in the EU in the first place. I take it as a given that it is in Scotland's best interests to be part of the European Union. I do not know of any mainstream opinion that would argue that we should come out. The first question I ask myself is, "Would there be any doubt as to whether we would remain in or whether we would have to apply?" Mr Barroso says that we would have to apply and Alex Salmond says that he does not know what he is talking about. It now turns out that Alex Salmond does not have the legal advice that he led us to believe that he had on that point. I do not know. If we had to reapply or even if we stayed in, do we keep the opt-outs that Britain has or will we have to apply for those? Where would be on the whole question of joining the euro, the Schengen agreement, fishing quotas? All these questions would be up for grabs.

I know enough about the European Union to know that there are two things that govern what happens. One is what the law says, but equally important is the politics. Europe is run by large countries. Some of them, especially Spain, will take quite an interest in what was happening if a country decided to break away from the UK but wanted to continue in the EU. Spain would have in mind that it has on its doorstep with the Catalans, the Basques and so on a similar issue, and they are not the only ones.

I keep saying that this is an area where there is significant doubt. It is not helped by the fact that we were led to believe that there was legal advice and it now turns out that there was nothing of the sort. It is such a critical issue and it really is critical to Scotland's future. I do not doubt for one moment that the First Minister will be able to find a lawyer to back up what he says, because lawyers can always do that if they need to, but what worries me is that there is so much doubt about this. This would not just influence our economic well-being. Critically, if you look at what is going on in the banking union that is now being set up in the eurozone, if I was running RBS or Standard Life or any these companies I would want to know who would be regulating me. How many people will be regulating me? If I do not know that, my investors start to worry. Remember you are not just talking about investors in England; you are talking about Americans, who sometimes have a knowledge of what is going on in parts of the UK that is not quite as thorough as we might like. The perception that something has changed and the perception that there may be uncertainty and doubt about who is running things can be extremely damaging. Again, why are we doing it? It is an industry that 10% of our GDP depends on.

Q571 Lord Hollick: Have you detected that those concerns that you have expressed are shared by the financial institutions and potential investors in Scotland?

Alistair Darling MP: Very much so, although they are reluctant to speak up about it, because they need to work with the current Administration. But of course they are concerned about it. Take the insurance industry in Scotland. Something like 94% of its products are sold south of the border, while 6% are sold here. If you own a company like that, you are bound to say, "What is this doing to the risks that I have, the systems that I have to operate, my cost base, and so on?" So of course they are worried about it. Equally, there are people who manage American money here—and Edinburgh is a very important financial centre in European terms. The first question that the Americans ask is, "Who regulates you?"

There is a final point here on another complication. If we become a member of the European Union, the law is that we have to have our own regulatory regime here. We could not borrow the FSA or the Bank of England at some point next year. The law says that you have to have your own compliant regulator, so that would be another thing that we would have to set up. Most of my constituents in the private sector work for these financial institutions and they are worried about it.

Q572 The Chairman: Everything that you say in response to that question adds up to huge temptations, pressures or however else you would like to describe it, for these financial institutions and the banks to headquarter elsewhere, where they have a regulatory system and a central bank that is well understood and accepted by investors.

Alistair Darling MP: Speaking to them, I think that they would be extremely reluctant to do that, because most of them have chosen to be here and grown here. They like living here and they like being here, where there is a very skilled pool of expertise. One has to be wary about shroud waving on this. My biggest concern is that the more you have uncertainty, the more doubts that you raise in people's minds, in the international financial services industry that is terribly unhelpful. It really is. Frankly, it is not going to be good enough for Scotland to hold on to what it has got; you are not going to survive that way. We need to get more people to come here; we have lost quite a bit after the survey in relation to HBOS. It is from that point of view that I worry that, in relation to people who are footloose and can go wherever they want, if we say to them, "Come here, but we can't tell you what is going on for a number of years", it does not help.

Q573 Lord Forsyth of Drumlean: Alistair, just following up on that point, and not wanting to indulge in shroud waving, you made the point earlier about the relative size of the banking sector in the Scottish economy, as opposed to the UK economy. One thing that struck me—I am in the middle of reading your book—was the extent to which the credibility of the UK was absolutely central in being able to mount the rescue plan that was carried out. If those financial institutions such as the RBS were to find themselves in an independent Scotland, given the size of the national balance sheet that would then exist, would that not have a knock-on effect on its ability to raise capital, and the cost to it of raising capital, relative to being located in the rest of the UK? However much it wanted to remain in Scotland, with all the advantages that Scotland has, would the economic pressures move it towards relocating south of the border, which was the Chairman's point?

Alistair Darling MP: First, thank you for reading my book. Secondly, Philip Hampton, who is the Chairman of RBS, said in the last few months that it is not an accident that large financial institutions tend to be based in large countries. When people look at a financial institution, they are going to ask where it is based and who stands behind it. If you look at Iceland, for example, an Icelandic bank would have a hell of a job pitching for business. That will be in people's minds. I passionately hope that we can do everything necessary to keep these financial institutions based in Scotland and to attract more, as our prosperity depends on it—it is too big to let go.

It is pointless to speculate what will happen, and I think that RBS would dearly like to stay here, for a whole range of reasons. But it is rather like the argument that we have perennially about London vis-à-vis New York or Hong Kong. From time to time, Governments have done things that have moved the centre of gravity—the obvious one is between London and New York, when the US Government introduced the Enron legislation. That gave London an advantage. From time to time, we have done stuff here that has pushed it the other way. That is just life—that is what people do. I am not in a position here to tell you that if you want particular things there are going to be certain consequences. This is a debate that we have had for two years, but the thinking on it is at a really elementary level. It is patently obvious that virtually no thinking has gone into how this would actually work, when this would disengage us from something that has been built up over many years and is complex, and has been built up for different reasons and at different times. You are talking about brining it to an end in fairly short order in a very uncertain world.

Q574 Lord Forsyth of Drumlean: Let me pick you up on something that you said earlier. You were asked about what the financial institutions were saying. I think that we both have a similar experience that they will say things privately; they do not wish to get involved in what is seen to be a political debate or say things that may damage their relationship with the Scottish Government. In the last 24 hours, we have learnt that it is quite difficult to get information that is trustworthy about central tenets of the debate. You mentioned the particular example of our relationship with the European Union. You, obviously, are wearing a partisan hat, because you are arguing against the break-up of the United Kingdom. Have you any thoughts about how it would be possible to get information that relates to the economic consequences of independence that is trustworthy and is not going to be seen as coming from a partisan source? In my days in the Scottish Office, there was a strong Civil Service, and there was a strong set of rules to separate a government announcement from one of my political press releases. It seems to me that these boundaries are being blurred. Do you have any thoughts on how we can get into the debate informed, objective and trustworthy advice on these big questions such as the lender of last resort, currency and so on?

Alistair Darling MP: Yes, I do. I know that it is something that you explored when Danny Alexander gave evidence to you last week. This is something that would be tremendously helpful. We have two years of debate at time when public esteem of all political parties is pretty low. We know from our own polling that when it comes to the question, "Who do you trust to tell you the truth?" politicians are right down there. There is a thirst to know some of these things; there are a lot of things that are just unknown and we will not know until we get there. The UK Government are planning, as I understand it, to publish position papers on a range of matters—10 or 15 different matters that they think are central to this. One thing that I hope they will do is to get them externally validated, or at least commented on. One thing that we did with the European assessment in the eurozone 10 years ago was to prepare a paper in the Treasury but then to get professors or other experts from outside government to pass judgment. They did not say, "Yes, that's 10 out of 10—that's right", or anything like that. They said, "Yes, these assumptions are reasonable", or, "We beg to differ on this". In other words, you have a UK Government publication, but someone from outside has looked at it and said that it is right or that they are not too sure about certain points.

I understand that the Scottish Government are going to publish a paper in about 12 months' time, which they will prepare. Especially following yesterday, I think that there will be a big credibility problem now. People will just not believe it. So for their own good, what I would do if I were them is to get it published and then get other people to look at it and say, "Yes, this is a stateable case". If we do not have that, the risk is that one side will say one thing and the other side will say another and the public will think that these are just politicians scrabbling around, and the whole process will not fit the debate that we need in Scotland over such a crucial issue.

The last point is that, in relation to Scottish firms, I hope that people who have a view about what happens to the country, whether in business or individuals, speak up. There is no point in keeping quiet and then saying, "I wish I'd said something". That will not do. Firms have said to me, "Look, we do not want to fall out with the Government"—although as I know to my cost it did not seem to stop them when I was in the Government. You have to remember that politicians need businesses here more than businesses need politicians, so they do not have anything to be afraid of. They need to speak up, because the public will listen to a big financial firm or someone who trades. They will listen to people who have no obvious axe to grind. You have just heard from Professor Kemp, who is a world-renowned authority on the North Sea. People will listen to him—and sometimes he will say things that suit your argument, and sometimes ones that do not. But that is how it should be. We need that discourse if this is going to be a debate where people can make up their mind on a reasonable basis—and I use that word advisedly—before they go to the polls.

Q575 Lord Forsyth of Drumlean: Another thing that you said, and which we have discussed this morning already, is that you need a set of rules if the Scottish Government are to use sterling in an independent country. I am not clear how you can enforce those rules. Would Westminster fine Scotland? What would be the stick with which those rules would be enforced? That is how the Maastricht criteria went wrong in the first place.

Alistair Darling MP: That is an interesting point. If you take the eurozone point, there is a Commission that sits on top which can enforce matters. There is no such structure here. Leaving economics to judges seems to me to be full of difficulties.

The Chairman: Would you like to go on to the subject of the division of assets?

Q576 Lord Forsyth of Drumlean: Yes. If you were back in 11 Downing Street, faced with the Scottish people having voted to break up the United Kingdom, how would you go about the division of the assets? Obviously oil is one, but debt is another. How would you approach that?

The Chairman: And liabilities.

Alistair Darling MP: My guess is that it would be quite a long process. Some of it is fairly straightforward. Some of it is just a case of changing from one country to another. However, there are complications such as the Royal Bank of Scotland, which I suspect, 10 years ago, people would have killed to get in Scotland, but I am not so sure now. It is physically here as a registered bank, but NatWest, for example, has by far the largest part of the retail side south of the border. That has implications for the deposit protection schemes and so on. There would have to be discussions about that. In relation to oil, there are probably enough pieces of treaty evidence and international agreements at the margins of the arguments. Certainly it is less complicated than you might think. As you have just been hearing, the whole question of decommissioning is far from straightforward. The rest of the UK might say, "Okay, we accept that geographically North Sea oil is in Scotland. No one told us that the government revenues were also going to pay for decommissioning costs". So it is bound to be more complicated.

Other areas, too, do not have the attention that they deserve. The area of pensions is one. Public sector pensions, as we all know, are pay as you go. What do you do if a civil servant has worked most of his life in London and retires to Edinburgh? Who pays his pension? How do you divide these things up, because there is not a fund you can divide up or anything like that? Equally, if you look at some of the shared functions, like HMRC and DWP, what do you do about the fact that a lot of HMRC and DWP employees work in Scotland but are largely doing work for people in the rest of the UK? What do you do about all that? Then there are the defence assets and so on. How do you divide them up?

I am not arguing that it is impossible—it is possible—but again we come to an interesting point that everyone will want the best deal for themselves. You sometimes hear the nationalists saying, "Well, don't worry, on RBS, we will only take on the liabilities close to independence", despite the fact that this entire calamity was engineered in Edinburgh, in Scotland. The idea that it is all the fault of the regulator is a bit like a bank robber arguing that the police should have stopped him. It is just nonsense.

It can be done but I am just wondering who will arbitrate at the end of the day if it does not work. Will we get an impartial referee who will judge this? Of course it can be done, but it is complex. Again, I hope that, over the next two years, we can have a little light on what the issues are. On some things we may say, "We don't know, but let's find out". If I were in receipt of a public sector pension, which I might be in a few years' time, I would like to know what the arrangements are.

Q577 Lord Tugendhat: There is another parallel with Europe, I think. If you look at the argument over banking union and the Spanish and Irish, and so on, should the new arrangements take account of the legacy debts? Mrs Merkel is saying that she only wants to take on the debts post the new arrangements. It is not a dissimilar arrangement. I want to ask you a question about tax. Do you expect that an independent Scotland will seek to introduce different rates of corporation and personal tax and, if so, to what extent do you think it has freedom of action, both in relation to the rest of the UK and within the confines imposed in the European Union?

Alistair Darling MP: Just on the question of debt, that is another issue where I suspect there will be quite a lot of fraught negotiations. It is important that Scotland will be moving into a debt market, where it would have a sales debt as a new entrant—the amount of debt that it had to service would be a critical issue. That is important. In relation to tax rates, let us take the corporation tax rate. When you listen to the arguments advanced by the SNP, one thing that they keep coming back to is that they want to reduce corporation tax. Therefore, I assume that it would change. That assumes that the European Union will let this practice go on much longer—as you know, it was deeply unhappy about what was going on in Ireland. As regards Ireland, you do not kick a man when he is down, but I can come back to that. Suppose Scotland cut its corporation tax and it worked. How long do you think it would be before the rest of the UK thought, "Well, it's working; who will cut our rate too?" Obviously, in the light of our economy, the less dependent on one particular tax stream you are, the easier it is to cut it. Then you get the ridiculous situation of beggar your neighbour, and the only people laughing are the multinationals who pay corporation tax. The rest of us either pay more tax or we will have people abusing the services or whatever. That is a simple matter of mathematics. I have always been sceptical about whether cutting corporation tax would make a big difference. There is no way that the other side will not retaliate. That is what happens when you turn your trading partner into a competitor.

In relation to income tax, it is interesting that, as you know, the Scottish Parliament has had power to raise income tax by 3 pence since we set it up in 1999, but no party has ever advocated that we do it. From 2016, the Scottish Parliament will have the power and indeed will be required to set the income tax rate. Will it do something different? It might do because it might be a political point. On the other hand, it might say that for all that you get out of it, why add another complication, for example, to a pension company that then has to do two separate calculations, depending on where the customer happened to live and hope that the customer has not moved too often between north and south of the border. I cannot forecast what they will do. All I will say is that if you start getting into tax competition with your next-door neighbour, it is not too difficult to see where it will end up.

Q578 The Chairman: Last week, as you may know from having read the transcript, Danny Alexander, in his evidence, spent a great deal of time speaking very strongly on the point that a Scottish Government, with its own debt, could face much higher borrowing costs than the UK and he gave a number of reasons. Do you share that view? As we are looking at the implications for the rest of the United Kingdom, do you expect the rest of the UK to face higher or lower borrowing if Scotland becomes independent?

Alistair Darling MP: First, it is interesting to note that, I think, Fitch, one of the credit rating agencies, was in it up to its neck when it came to certifying subprime mortgages. We have to take what they say with a pinch of salt. They tend to follow the markets rather than make them. That is worth noting. Fitch said that the rest of the UK would maintain its AAA rating. It passed no comment on Scotland. It did not say Scotland was lower, but just passed no comment. Others have made the point—I cannot remember which rating agency it was—that it would be unusual for someone new in the market to come in with a AAA rating. There are very few left with a AAA rating now. This is no criticism. You might be an exemplary country, in terms of what we expect you to do, but it is like opening your first bank account: you tend to have a rather modest overdraft facility so that the bank manager can see what your track record is and whether you repay things at the end of the month and so on. That is something that Scotland should take account of. You also look at how much debt you have and what is the term in which you repay it. The average maturity of the UK debt is 14 years; in most other countries it is seven years. It is why we are never at any serious risk of not being able to service our debt, even in the darkest days.

The other thing that people would simply have regard to is one of the things we were talking about earlier: what is your measure of last resort facility and what is your central bank and so on? There are a lot of unknowns here. The final point is that you can compare well established countries, such as Germany, with the Netherlands or Finland, which people generally say run a tight ship in terms of their budgets, but which pay more than Germany does. So there is a premium, an extra cost, because they are smaller countries.

Q579 The Chairman: Do you see any way in which those costs of borrowing could be alleviated by actions that a future Scottish Government would take in the short term and the long term?

Alistair Darling MP: Were Scotland to become independent, the Finance Minister would have to err on the side of caution and prudence for some time, until there was a track record. You are probably aware of the debate in Scotland about the extent to which you can provide free this and free that in the face of a population that is growing old at an alarming rate. Our guess is that, as with any new bank customer, any new business or any new country—that is what it would be—it would have to bend over backwards to show that it is not a big risk. That would have repercussions on what you can do for the population as a whole, who may view things entirely differently, saying, "Why are you kowtowing to the money markets? Why are you doing this when we want you to spend more on this, that or the other?" Again, I would never argue that it is not possible; it is just that we should not go into this with our eyes half closed.

Q580 Lord Levene of Portsoken: Do you expect that, in an independent Scotland, the non-oil sectors might be weakened because of the enormity of the oil sector?

Alistair Darling MP: I do not think that it is axiomatic that that would be the case, but there is a long-running problem here. If you take the non-oil sector and, for this purpose, the financial services sector and manufacturing, we have some very good companies in Scotland and we have done extraordinarily well out of them, such as our start-ups, and there is a lot of innovation and invention coming out of Scottish universities. Historically, though, we have had a problem, as indeed has a lot of the UK, in getting them to go from that start to being something that employs a fair number of people and is well established. That problem is not unique to Scotland but, if you look at the make-up of the Scottish economy, the thing about oil that worries me is that no one knows when it is going to run out. There might be a move to the right whenever you are asked this question. By definition, it is going to run out one day or become so expensive that it will become less attractive; that is what happens when you are using something that is not renewable. It is also very volatile in terms of your revenues. This is another important matter: if we are going to grow the manufacturing sector, for example—the non-oil manufacturing sector—we need to be better than we are at the moment on innovation and invention, and it is UK research money that Scottish universities are using here. That is another issue; universities have to ask themselves, "Where's that going to come from in future?"

Q581 Lord Levene of Portsoken: As a follow-up to that, in the event of an independent Scotland, bearing in mind the crisis that the financial services sector has been through, do you think that it would be even more difficult for the financial services sector in Scotland to keep its head above water if it were operating in an independent country?

Alistair Darling MP: I am not sure that I would agree with that. The health of the Scottish financial services sector, as for the financial services sector in the rest of the UK, will depend on people believing that there is a more robust supervisory regime than there was in the past and that they have put their house in order. Most financial institutions in this country, unlike in continental Europe, have done that. People can see them moving in the right way. What is troublesome to the Scottish sector is that people do not know who is going to be regulating them and what the rules and regulations are going to be. If you asked people in the financial services sector, they would say, "Until we know what the rules are, we don't know and can't tell". That is the problem.

Lord Levene of Portsoken: That was my point—who is in charge and what experience will they have?

Alistair Darling MP: I think Scotland would probably have to have its own regulatory regime, simply because the European Union—assuming that we want to join and were joining—required it to have it. You would have to invent something from scratch. Given what has happened in the financial services sector, and given the fact that RBS was very much a part of what went wrong, it is clear that regulating banks is not easy. Finding someone who understands what is going on is not easy. If the bank directors did not know what was going on, how can we expect someone who has just walked in off the street to know?

Q582 Lord McFall of Alcluith: Scotland has had a trade and current account deficit with the rest of the UK for a while now. If Scotland were to become independent, and given the geographical shape of the oilfields, do you think that that overall trade and current account deficit would continue, or could you see opportunities for there to be a surplus?

Alistair Darling MP: I do not know about a surplus, but the figures since devolution show that there have been years when Scotland has done better and contributed more and years when it has contributed less, although this is an inexact science and this analysis has not been done officially. It is interesting that the percentages pan out so that in some years you do better than others. For Scotland to be in surplus, it would need oil prices to spike. You would need sky-high oil prices with sky-high prices at the pumps. That obviously would not be a great position to be in. At the moment, both the UK and Scotland are running a deficit; that has been the case for a number of years and it will continue. Without North Sea oil, Scotland would be in a terrible state. I do not think that anyone is arguing otherwise. You might argue over exactly how much it gets, but let us assume it is getting what is commonly thought to be its fair share. The thing about oil is that it is terribly spiky; production fell by something like 10% in 2009. You are dependent on investment decisions being taken by Texans—not by people sitting here. Once the stuff comes out of the ground or out from under the sea, a lot of it goes abroad. It is a very volatile thing to have, although it is nice to have when it is doing okay. Like everything else, you need not to look just at one year, which the nationalists repeatedly invite us to do; they take one year that happens to be particularly advantageous for them. You need to look at the issue in the round. People say, "What's the positive case for Scotland in the UK?" Being part of a larger unit means you are better placed to absorb the shocks that come from time to time. North Sea oil is about 1% to 2% of UK GDP but about 10% to 20% of Scotland's, and those figures speak for themselves.

Q583 Lord Hollick: You discussed the challenges of an independent Scotland joining the European Union. Is there another option, which is to join the European Economic Area?

Alistair Darling MP: You could, but I do not know why anyone would want to do it. The majority of people in Scotland, and certainly the clear majority of businesses, want to be part of the European Union. Here is another thing. As a number of you around the table who have been Ministers will know, when you go to Europe you find that it is run by large countries, not small ones. That may be wrong and may not be what everyone would want—certainly they would not say so—but it is the case. Look at what is happening at the moment. Which capital would you go to if you were going to Europe and you wanted to get something done? It is in the largest country. If I were a business in Scotland, I would take the view that so much of what I did was affected by Europe one way or another that I would want to make sure not just that I was sitting at the top table but that I had as much clout as Germany and France had. That is critical. Why on earth I would want to be in the EEA, I do not know.

Q584 Lord Forsyth of Drumlean: To go back to the issue of lender of last resort, since, as you pointed out earlier in your evidence, the Bank of England is effectively guaranteed by the taxpayer, why would taxpayers in the rest of the United Kingdom wants to lend money to a foreign country, which is what Scotland would have become? Why would there be a lender of last resort facility? To half answer my own question, given your experiences with the banks that were too big to fail and the relative size of the banks to the economy, would an independent Scotland that got into financial difficulty be too big to fail from the point of view of the taxpayers in the rest of the UK?

Alistair Darling MP: Dealing with your first question, I think that my answer was that the Bank of England could act as lender of last resort. Would it? I do not know. Suppose that some country came along and said, "Could the Bank of England please be a lender of last resort for our country's banks?" I suspect that most people in this country would say, "No, it can't—do it yourself or find someone else." Obviously, were Scotland to join the euro, the ECB would be the lender of last resort.

On the second point, I have heard the nationalists say two things. First, they have said the Bank of England would agree to do it if you paid a premium. That is a bit like saying to an insurer, "I'd like to insure my bank," and them responding, "Have you made any claims in the past five years?" Well, RBS has made quite a hefty claim recently. The second point that they argue, and I see that they have managed to get some academic support for this, is that if a bank failed—say that RBS failed again—people would all chip in if it went down. In other words, the rest of the UK would chip in, the Americans would chip in and so on. All I can tell you is that, on the night of 7 June 2008, no one at all anywhere in the world rushed to chip in to bail out RBS, despite the fact that it had a very large trading arm in the United States and many of the losses that it made were there. Obviously the US Fed was immensely helpful in terms of liquidity support and tiding over; it kept RBS going for a whole afternoon when it got into trouble on that Tuesday. When it came to recapitalisation, though—I think that the recapitalisation figure is about 30% of Scottish GDP—there was no one queueing up to do it. As Mervyn King said, these banks are global in life but national in death. That is the way that things are, I am afraid. There is no point in hoping and saying to anyone, "Please sir, will you come and bail out my bank?"—they will tell you where to go.

Q585 Lord Forsyth of Drumlean: What about the point about being too big to fail?

Alistair Darling MP: As I said, in 2008 RBS's balance sheet was only slightly smaller than UK GDP. Actually, in January and February 2009 when we had to give them some supplementary support, it was just a bit bigger than UK GDP. We can do that because people do not doubt our creditworthiness. The case might be different if you have a much smaller GDP. This is not a criticism of the country concerned, but the Irish and Icelandic examples reveal a lot. People would say, "I see that the Irish banks guaranteed every deposit. How much are the Irish Government worth? How much are their banks worth?" What happened was that the guarantees were worthless.

Lord Forsyth of Drumlean: The nationalists would argue that we have already done it with Ireland; we lent Ireland money and I believe that they are paying 6% for it. There is a precedent.

Alistair Darling MP: But that was after Ireland was bankrupted. Ireland just could not go on. It had help from the European Union, the eurozone, the OECD and the IMF. We gave it £8 billion, not least because if you put your money in the Post Office bank, not everyone is aware of the fact that it is in fact the Bank of Ireland.

Q586 The Chairman: We have got through a great deal of material. Are there any further questions or final points that you would like to put to us?

Alistair Darling MP: The only point that I would make is this, in reply to Lord Forsyth: the more pressure that can be put on both sides—both Governments, that is—to publish information, the better. There will always be contestability here and something special that we do not know, but it would be so much better if we all did. The past 24 hours in Scotland have been depressing beyond belief. If people do not believe what is being said to them by their politicians on either side, they are going to despair. That is the last thing that we want regarding the biggest decision that we have made in 300 years.

The Chairman: We very much agree with that. We had a discussion last week with Danny Alexander and Sir Nicholas Macpherson, the Permanent Secretary at the Treasury, on this very point. The Treasury is now doing quite a lot of work, and we have asked for a paper to indicate exactly what subjects it is covering and what the timetable is for publication. I hope that that will help our work as well as the wider public. We have got through an enormous amount of material at a rapid pace and managed to meet our deadline of finishing by 1 pm. I am very grateful to you. Thank you very much, Mr Darling.

Examination of Witnesses

Ruth Davidson MSP, Patrick Harvie MSP, Johann Lamont MSP and **Willie Rennie MSP**

Q587 The Chairman: Thank you all very much for coming. I think that you are aware that our Committee is concentrating only on the economic aspects of Scottish independence and the implications for both Scotland and the UK. We are not looking at any other aspects. I think that you are also aware that we feel that there is still insufficient debate about some of these major issues—I hope that our Committee's inquiry can help to enlighten on some of them. Do any of you wish to make an opening statement? We have to rattle through, as you know, because we have four of you and a limited amount of time, but would any of you wish to make an opening statement or shall we go straight in?

Patrick Harvie MSP: Only thank you for the invitation to participate.

The Chairman: I thank Johann Lamont for the excellent paper that she gave us. It is a very well put together paper, which we had only very recently, but we have all had time to look at it. Thank you very much. Could I start then by asking what are the economic pros and cons to independence?

Johann Lamont MSP: First, can I just say thank you very much for the invitation to be here? Of course, the test over the next period will be for people in Scotland to answer what those economic pros and cons are. It is essential that that is a rigorous and thoughtful debate rather than assertion. I start from the position that Scotland can survive on its own. The question is whether it would be in the best interests of the people of Scotland. I feel very strongly that Scotland in partnership with the rest of the United Kingdom has been able to have a strong economy. The rest of the UK is also clearly important in terms of being Scotland's biggest market. We are part of a larger economy, which allows us to pool resources and to share them in tough times. It protects us from some of the financial shocks that might be experienced, and that stability allows us then perhaps to push forward Scotland in the United Kingdom. It offers a base for economic stability and opportunity across Scotland in terms of the economy.

Ruth Davidson MSP: I thank the Committee for inviting me here today. I believe that if we look at the case for Scotland being an independent nation, it is not just a simple zero-sum analysis of the economics. It has a lot to do with our cultural and social history; it has a lot to do with our character as a nation and with our individual identities. In terms of the economics, though, as this is the particular element which this Committee is looking at, I have yet to see an economic case for independence and I do not believe that those who are espousing the separation of Scotland from the rest of the UK have made that case. When we look at Scotland within the United Kingdom, I believe that both Scotland and the rest of the UK benefit from being part of that union. In the stability of our banks and financial institutions across the UK and in Scotland, the role that oil plays in the Scottish economy, and the ability to service our debts at low interest rates and to borrow from foreign nations, you will see as we progress that there is a benefit to both Scotland and the rest of the UK from remaining in the union.

Willie Rennie MSP: I am Willie Rennie and I am leader of the Scottish Liberal Democrats. Thank you for inviting us to be here today. One of the fundamental problems with addressing this question is that no modern successful country in the past has broken itself up to become a smaller nation. It is perfectly possible to be a modern, successful, small nation—you can cite Norway, Sweden, Denmark and various others. The question is not whether you can be successful by being Scotland; it is whether you break you yourself up if you are a modern successful country with the single market and the social equity that we have across the UK in order to become smaller. That transition in a modern world is extremely challenging. If you look at financial devolutions, these are much more complex than they were in past—for example, in the cases of Norway and Sweden. Welfare states were not as complicated as they are now. The transition process is really quite a difficult thing to come to terms with. You can cite eastern European countries, but they split from the Soviet Union when it was on its knees, so they are not exactly comparable. African countries likewise are not comparable. Sweden and Norway split before the issues became as complex as they are now—there is no rule for how you do these things, so it is difficult to say what it would actually look like. The issue is not independence; it is the transition to becoming independent which is one of the most challenging things.

I concur with what Johann and Ruth have said—there are significant benefits from being in the single market in the United Kingdom. We can trade freely; we can have social equity, so you can smooth the peaks and troughs in different parts of the country. When we have difficulty, we can organise around it; we can pass round the benefits of that. That is one of the great benefits of the UK. So that would be my case. It is very difficult to be absolutely sure whether we could do that as an independent Scotland.

Patrick Harvie MSP: I, too, thank you for the invitation to take part, which I hope reflects recognition that there is a small but growing faction of politicians in Scotland who support a yes vote but who are not part of the SNP. Like Ruth, I think that we should not be making a decision about this question of independence on the basis of the economy alone. I would hope that you would not expect the Green Party to advocate a position that places GDP growth on a pedestal—a big part of the reason why we exist as a party is to challenge that notion. If we put other economic priorities ahead of that, such as tackling economic inequality, it is pretty clear that, from the beginning of the Scottish Parliament onwards, we have been unable to take a coherent approach to such issues because of a lack of ability to deal with the substantial aspects. We have responsibility for issues such as debt management, but we do not have responsibility for credit; we have responsibility for many of the effects of economic inequality but not for the structural causes. I would see an economic opportunity to put other priorities such as tackling economic inequality ahead of mere economic growth. But I would agree that no voter in Scotland, no policymaker—thinking about how they would manage the transition—and no politician should sell or buy a simplistic message like everyone will be £500 better off or everyone will be £500 worse off. Willie Rennie ended by talking about uncertainty. We need to face this question about Scottish independence and its implications in full recognition that everybody the world over is facing profound and unprecedented uncertainty and doubt in terms of economic crisis and ecological crisis. That will face Scotland whether we stay part of the UK or not. The pros and the cons will continue to be mixed whichever choice we make.

The Chairman: Thank you. Perhaps I should just say this for the benefit of the wider public. People may wonder why we have here for this session four leaders of political parties in Scotland, but not the leader of the SNP. We did invite Alex Salmond to come and give evidence to us separately. He has declined to do so and suggested that we apply to Mr Swinney, but he could not be here today. We are hoping to see him as a witness, but unfortunately we will have to hold our hearings in London. That explains why we have four witnesses.

Q588 Lord Tugendhat: For many years, the SNP has advocated the use of the euro as Scotland's currency, but now it advocates the use of sterling. I would be grateful if you could tell the Committee which currency you think would be most appropriate, and about the advantages and disadvantages.

Johann Lamont MSP: In a sense, that is an answer that the SNP has to provide, but it has significantly failed to do so thus far. Those of us who advocate staying inside the United Kingdom recognise the strength of sterling and the strength of monetary and fiscal union at a time when everyone is highly anxious about the circumstances. Of course, in the past the

SNP's position was to be in the euro, but they now say that they would want to stay inside the sterling zone. But they have been unclear in which context. Would they simply assert this and then use the currency? If they do that, there are risks, because they then would not have a lender of last resort. They have of course said that they would enter into a compact with the rest of the United Kingdom on sterling, which of course would mean that a separate country would have very significant control over our monetary and fiscal capabilities. It is inconceivable that you would allow Scotland to be part of sterling and not demand that there be some coherence in relation to fiscal policy, especially if you are going to give a guarantee as a lender of last resort. So we are in a place where it seems to me that a separate Scotland in sterling would either simply be free floating, with all the risks that involves for ourselves, or it would go into an agreement with the Treasury and the Bank of England and be subject to constraints, at the same time as those bodies would not have to take into account Scotland's particular interests in the decisions they make. My view is certainly that we would be in a weaker position than we are in now. For all the SNP's assertions that Scotland would have a place on the Monetary Policy Committee and that that would be entirely acceptable, there is no evidence on that. There are very hard questions, which have to be answered around the implications and the nature of the agreement.

In March of this year, Alex Salmond said that of course there would need to be a fiscal stability pact, but he has also said as recently as in September when he was in America that we would not require a stability pact. There is a huge degree of vagueness around how sterling would work, what the consequences would be and the influence on Scotland's needs and interests in the thinking of those who are making the political decisions around monetary and fiscal policy.

Ruth Davidson MSP: I may be a wee lassie, but I actually go back further than Johann Lamont, and I remember a time in the late 1980s when Alex Salmond was espousing the

Scottish pound to the House of Commons. So we have had three clear positions from the SNP in the last 25 years: first, for a Scottish pound; then to be part of the euro—certainly until around, I think, late 2009 it was advocating that—and now to have sterling and to operate in a similar way to Ecuador and Panama with the US dollar.

There is a question here that goes beyond what those who espouse an independent Scotland wish the currency of that nation state to be. The question is: is that within their control? We found out very clearly yesterday from events in the Scottish Parliament that the current Scottish Government have no knowledge, or certainly no legal advice, to back up an assertion that has been made for some months that they would be a nation state within the European Union. This has implications for the currency because if that is not the case and if a new nation state was built as a separate Scotland, and it had to be an accession state to the European Union, then that country would not have control over what currency it would have. That is because one of the rules for joining the European Union is that sooner or later you have to adopt the euro. There are huge levels of uncertainty surrounding what you spend out of your own pocket should a separate Scotland come into being.

There is one point that I would like to develop out of Johann Lamont's testimony. Were it to come to pass in the current SNP model where we had a sterling zone between a separate Scotland and the rest of the UK, what protections would be in place for businesses and consumers? It is unclear from the model that we have from Alex Salmond and his Finance Minister, John Swinney, as to what protections there would be. Who would be the lender of last resort? Who would be the financial services regulator? Would there be the same protections for consumer savings over £85,000, which are the protections we have in the UK right now? Could they be extended to Scotland and, if they were, who would that body be? Is it even legal to have the Bank of England operating in the way that the SNP has suggested might be the case, in terms of being a regulator for some of our financial industries? So far as I am aware, every single European nation has its own regulator, including tiny Malta, and there is testimony from people who work high up in Scottish financial services saying that that this could be against European law. So there are huge questions surrounding the whole area and I am not entirely sure that they are questions to be put to the people who espouse Scotland remaining a full member of the UK. For those who have a prospectus to split up Great Britain—perhaps Patrick will be able to explain—these are the questions that the people of Scotland need to have answered before they can make such a decision.

Willie Rennie MSP: Ruth Davidson referred to yesterday's events.

The Chairman: You could not avoid it.

Willie Rennie MSP: It is typical of the way that this has been approached. It is all based on an assertion. You will get different legal opinions from a variety of sources, depending on who you speak to. What is clear is that the Scottish Government are duty bound to look at the scenario of what would happen if Scotland was required to join the euro. So far, all they have done is to say that they will continue with the pound and see how that will work. I am not asserting that we would have to join the euro, because that is yet to be determined, but what I am saying is that they have a responsibility and a duty to look at what would be involved in us joining the euro. What would be the requirement on the deficit? There is the requirement in order for us to join the euro that we bring the deficit down to something like 3% of GDP. Scotland's is currently around 7.4%, based on Alex Salmond's favourite figures. So we need a significant reduction in public spending, of the order of £5 billion. I think we need to explore that avenue as much as the SNP is exploring the avenue of sterling so that voters can go to the polls in a referendum with a full understanding of the possibilities. If we do not clear this up and get some clarity on what could happen—not what Alex Salmond says will happen—we could be leading the voters to the polls without full knowledge. As yesterday showed, we want to avoid an endless argument about the legalities of this. What we really need to do is to look at all the possible scenarios so that people are fully aware of what might happen.

Patrick Harvie MSP: I agree with Willie Rennie about the need to be clear about all the possible scenarios. To be clear, my preference would be that the scenarios would still include at least the possibility over the long term that a separate currency could be put in place. It is clear that that is not an immediate possibility any more than joining the euro would be the immediate preference of pretty much anyone in Scotland, I should imagine.

One of the problems—it came up yesterday—is the question of automatically negotiating EU membership. My suspicion is that that cannot be properly interpreted until we know on what basis the referendum is going to be held. What kind of legislative process will we have afterwards in the event of a yes vote? It seems to me that understanding the emergent status in the process of independence needs an understanding of the legislation that we pass in the UK Parliament and in the Scottish Parliament in order to give effect to the will of the people of Scotland if they vote yes. Neither Government are likely to be in a position to begin to flesh that out until after the referendum. We need to be clear that all of these possibilities need to be developed, but none of them is likely to look like a guaranteed bet until the Governments are placed in a position where they have to negotiate on the basis of a mandate from the referendum. I am happy to acknowledge that, whether I was lucky enough to be the First Minister with the whole Civil Service to help me answer these questions, or a MSP from a group of two with a tiny team to help me. This is one of the hardest aspects of the yes campaign. I do not think anyone should pretend that, two years out from the referendum, we are in a position to know for certain what the position of the UK Government will be in the event of a yes vote. I think we need to know that in the long-term scenarios. Perhaps 10 or 20 years after the yes vote an independent currency might become possible, but it will probably take that long.

Q589 Lord Hollick: Mr Harvie, you raised the interesting notion that this is really a two-step process: there is a referendum on the principle of independence and then there is a period of negotiation which would then lead to a legislative process. Or do you think there will be another referendum? It seems to me that the great difficulty, to which all of you have referred, is that a lot of the detail of this will not be known until a negotiation has taken place. Therefore, the referendum in 2014 will inevitably be taking a view on how that negotiation might turn out.

Patrick Harvie MSP: Some people have made the case for a second referendum based on the outcome of the negotiation process. My only point was that that negotiation process will not begin until both Governments are faced with a mandate in the event of a yes vote. My point about democratic legitimacy would be around the development of a constitution in the event of a yes vote. There would have to be a process of developing a constitution in as participative a way as possible. That probably cannot take place until people have dealt with the shock of the result and a new UK Government are in place, however many months after the referendum. The adoption of a constitution would be required before the transfer of powers could be undertaken. I would argue for a longer and slower and—I am crossing my fingers here—calmer process than the First Minister has in mind: the 16-month headlong rush from referendum to the transfer of powers.

Johann Lamont MSP: A great deal of the uncertainty has been developed not by those who have been asking hard questions about the consequences, but by the answers from those who have advocated for 40 years that Scots separate from the rest of the United Kingdom. That is astonishing. One might have expected that you might be able to answer some of these questions. To give one small example, in 2009, the Finance Secretary said that he would want financial regulation to come to the Scottish Parliament. In 2011, he said, "Well, perhaps it is a more complicated issue and really we need to look at this on a global and European scale". Then this year he said that we would want the regulation to be the same as for the rest of the United Kingdom, despite the fact that there may be issues around the European Union. There is a very significant concern about the economic impact of independence. What is currently the economic impact of that degree of uncertainty? I was struck when I was preparing for this by the extent to which this will be a huge, long, complicated exercise or process that will take huge amounts of the time and energy of some of the best brains in the United Kingdom. I have one small suggestion. When Czechoslovakia separated, it took them seven years to agree on the gold reserves alone, so one of the things that we need to ask is about the urgency and certainty. There are very basic questions around the currency and financial regulation. It is not about the normal to and fro of the political process; it is about the extent to which the energies of our political process will be drawn into something hugely difficult while the rest of government will not have a focus at all. There is a huge challenge. I hear what Patrick Harvie says about how we really cannot deal with all of this until we agree, but unless you know these things it is very difficult to see how people are afforded the opportunity to make a decision about something that is not reversible. The First Minister says that it will be the most significant thing to happen to Scotland in 300 years but that it will also result in very little change at home. Those things cannot both be true.

Q590 Lord Tugendhat: I have a very brief question. It seems to me that there is a real problem about having a referendum, then a negotiation and then a referendum on the conclusions. The Scots have a vote—we English do not have a vote—on separation, but if an agreement is reached between the two Governments, then the Scots could have a referendum, but we would have to have a referendum too about whether we accepted those proposals. I do not think that you can have a two-stage operation.

Willie Rennie MSP: Having a second referendum was explored previously, but people need to realise that once you have taken the decision to leave, you are gone. That is it. There is no turning back, no return to the United Kingdom. People must not think that there is a safety net.

Q591 Lord Forsyth of Drumlean: I wonder if I could just pick up on one point—I am trying desperately not to be partisan here. I thank Johann Lamont for the paper, which is very well argued and helpful. Based on what has happened in the past 24 hours, is there not a problem if you are living in Scotland and thinking about how you are going to cast your vote on this important question? There are a number of issues, such as the currency, our position in the European Union and the rest, which are absolutely central and crucial, but if you think that the sources of information are either partisan or, even worse, untrustworthy, how do you form a view? You are all very much involved in the Scottish Parliament as leaders of your parties, but in my day, when I worked in the Scottish Office, I would say things and sometimes our information office, which was independent, would tell me off for being too partisan when I was acting in a government role. Do you have any thoughts or ideas on how we can ensure—particularly as this Committee is concerned with economic issues—that people can have sources of information on economic issues that are reliable and trustworthy, because it seems to me that the referee is wearing one of the jerseys at the moment?

Willie Rennie MSP: It has been suggested that there should be an equivalent of the Office for Budget Responsibility which would oversee and adjudicate on some of these economic issues. There would still be a debate within the figures, but if you at least have a foundation for the figures which we would could all understand and agree, there could be positions based on them. An Office for Budget Responsibility, independent of government, accepted by all the political parties as neutral, is a reasonable suggestion. There would have to be an acceptance and understanding that it was a body that we could all accept. I think that that would be a reasonable way to proceed. It is something worth looking at.

The Chairman: You do not all have to feel that you need to answer each question.

Ruth Davidson MSP: I agree with Lord Forsyth that people need to have reassurance of the process put forward and each side will argue its own case, but there has to be some basis in fact and some evidence to support the arguments of the case. I think that there has been erosion in the trust capital of the current Scottish Government and its ability to present facts. In terms of independent information and advice that is available from Scotland, there is an information service attached to the Scottish Parliament which can present information. How that information is interpreted is not subject to the referee figure that Lord Forsyth talked of. I am not sure whether duplicating the Office for Budget Responsibility in Scotland is the way forward, but I think that there needs to be some way, in what is going to be a very long campaign—two years of claim and counter-claim—in which people can separate the wheat from the chaff, otherwise it all becomes white noise and everyone goes into a state of confusion rather than having information on which they can make the best decision for themselves, their families, the community and future generations.

Patrick Harvie MSP: I have no objection to the idea of an independent unit. I have two comments. First, I do not think that there is any such thing as neutral and impartial economics any more than there is neutral and impartial politics. All of it will be subject to interpretation, and perhaps multiple interpretation. Secondly, all parties have now accepted the principle that there should be a referendum and that the people of Scotland have a right to make that choice. It would be harmful to the debate in general—not necessarily to one side or the other—if either side started to demand that their opponents produce a crystal ball to say what would happen in Scotland if people voted one way or the other. No one can give a cast-iron guarantee about what will happen to the economy in either situation. This is about what powers we wish to exercise in a world riddled with doubt and uncertainty, and I would like to be able to make those choices in Scotland.

Johann Lamont MSP: Very briefly, I think that Patrick Harvie makes absolutely the right point: you have the information and then, as a human being, you tend to have values and aspirations. The challenge will be, first of all, for politicians to stop closing the debate down and seeing it through our own situation—whether that is anti-Scottish or pro-Scottish, or whatever. They need to stop framing the debate in those terms. That is really important. There has been a political culture over the past few years that seeks to intimidate over what we seek to debate. It is such an important decision that on all sides we need to open that up. I would make a plea to those beyond the political bubble—the academics, the business people, the trade union people—to start speaking. It is incumbent on those who have a view, one way or another, not to oppose that. There has been a bit of a culture in Scotland over the past few years with people being anxious about speaking out. In the next period, how do we get the expert understanding of what is going to happen in communities if, first, people are to be allowed to speak out and are encouraged about their responsibilities to do so? Otherwise, although we all think we can make a fantastic contribution, it will be very much be along the lines of "He said" and "She said". This is about pulling the rest of Scotland into this debate, with people having an understanding of and respect for this.

Q592 Lord McFall of Alcluith: At the back of my mind is the question: how do we get an evidence-based referendum? If you are not confident that you will get an evidence-based referendum, given that your parties are cumulatively almost 50% of the representation of the Scottish Parliament, is there a way that you could work together to get that, to bring civic society in and bring in the academics and work to get the economics on board? If we do not have that, we will have the situation mentioned by Professor John Kay, who is on Alex Salmond's Council of Economic Advisers, and it will take four years of protracted negotiation and concern for people. That will do nobody any good. So can you all work together to get that going?

Johann Lamont MSP: I just say that, as a co-operator, I always like to work together with other people. I think that is right. Across political parties, it is important that people identify the key issues and are seen to debate them. The point I was trying to make is slightly different. Those who are expert in the evidence and understanding need to be encouraged now to bring that to the table.

Lord McFall of Alcluith: Can you have an initiative to establish an umbrella organisation that would include civic society so that we get that evidence base? That is the point I am making here.

Johann Lamont MSP: I am not sure that we need to reinvent the wheel here. I think there these organisations, including the SCVO, already engaged in this debate. We know that there are views in the business community, the trade unions, community organisations, and so on. It is about finding the space so that people are able to speak out. We have already had evidence from a range of experts, particularly on the economy, and they have brought their understanding of what the situation will be. I think that this will happen naturally, but the challenge will be, frankly, for the Scottish Government and those in opposition to recognise, as we go through all this, that whatever the immediate concerns are, it must be about more than that. The power of the state is very significant and I just think that there is a need for that to step back so that people feel free to express their views on the constitution.

The Chairman: I have a slightly different challenge in that I have a time constraint on getting this session through. I fully understand and sympathise with the fact that all of you want to speak on every question, but if you are in agreement with somebody else, just say, "I agree". That would be helpful.

Q593 Lord Forsyth of Drumlean: Perhaps I could direct my question particularly to Mr Harvie. Can you explain to me why anyone would imagine that the Bank of England would want to be lender of last resort to a foreign country, given that the Bank of England does not have any resources other than what is provided by taxpayers standing behind it and that, if Scotland becomes independent, taxpayers in the rest of the United Kingdom would be asked to act as guarantor to a foreign organisation? Why would that conceivably arise, and what do you think the politics of that would be in the rest of the United Kingdom if it had been broken up?

Patrick Harvie MSP: We cannot really speculate about the politics of that because we would not know the nature of the UK Government at the time.

Lord Forsyth of Drumlean: I am thinking of the voters.

Patrick Harvie MSP: I do not believe that the Scottish National Party, with Alex Salmond as First Minister, should be asserting that this is a scenario which can easily be established. He is right to be focusing on it as a possibility. It is one of the things that would need to be negotiated between the two Governments. It might be something by way of an insurance policy arrangement—a situation where, as part of the negotiation about the finances of independence, this is one of the things that is taken into account. It might be that there are other options that the Scottish National Party Government has not investigated so far. If there is one element of your question that I would agree with, it is that the SNP Government should not be asserting that this can and will happen. I come back to the other point I made before. The negotiation process is not possible until a mandate exists. It is not possible to be clear about either the attitude of the UK Government or the responses of the Scottish Government to its positions until a mandate exists. That is why I think we should be making this decision on the basis of principle rather than on the basis of every promise that we hear from Mr Salmond being a guarantee.

Q594 Lord Hollick: Would you not agree that one consequence of Scotland remaining within the sterling area, if I can call it that, is that there would be a need for Scotland to agree its budget with the United Kingdom? So, far from being free as a bird, there would be a need to sit down with the United Kingdom and agree the budget in some detail, otherwise maintaining sterling would not be possible.

Patrick Harvie MSP: I agree that it is highly likely that a UK Government would find that a necessary position to hold and it would have absolute priority in a negotiation process. That is one of the reasons why I would personally prefer to see any period of continued use of sterling as a transition period leading to something separate. It might be a matter of years or it might be a matter of a generation, but I would prefer to see it in those terms of a slower separation of process rather than a one-off moment of independence. To paraphrase, I would say that independence would be a process rather than an event.

Willie Rennie MSP: You are absolutely right that independence and adopting the pound would give Scotland less freedom rather than more. The terms would be set by the United Kingdom Government, who would be the lender of last resort, and financial controls would be imposed. You might argue that, with the strength of the oil price, Scotland would have a significant weight and it might be more of a negotiation, but I think there would be even more of a requirement for Scotland to live within its means as set down by the United Kingdom, so I think there would be less freedom rather than more.

Q595 Lord McFall of Alcluith: If there was a single pan-UK regulatory authority, would this encourage Scottish firms to become bigger than the Scottish tax base would allow on the implicit assumption that, since they are regulated by the UK, they are the responsibility of the UK? Would there be a perception that any too-big-to-fail institution would soon become an issue for the rest of the UK? I am thinking of Ireland when it gave a blanket guarantee. At the end of the day, the UK came in with £7 billion to assist Ireland. Do you think that the rest of the UK would find itself in a similar situation as regards Scotland?

Johann Lamont MSP: I would work on the assumption that, if you are getting guarantees from the rest of the United Kingdom, there will be conditions laid on that. There is a conundrum at the heart of this: why would a separate state from which you want to free yourself because you feel that you are not either socially or economically close enough feel any obligation towards you? That is how the language is sometimes couched. Why would that part of the United Kingdom feel any obligation towards you whatsoever? I would have thought that any separate remainder state of the United Kingdom would be very concerned that if it is giving grants and things to Scotland there should be conditions applied. I think that goes to the heart of this issue around financial regulation as well. There is no clarity about how that would work. It flows over into other positions that the SNP has, including what it would do as regards corporation tax. Patrick Harvie says that there would need to be negotiation, but the reality is that the only thing the rest of the United Kingdom would need to negotiate is how we share out debt and any assets. They do not have any residual obligation to go beyond that. There are assumptions made about the obligations on the UK side. This issue is a good example of where the regulatory body would be looking to the consequences for the remainder of the United Kingdom in defining what conditions would be applied to Scotland. If Scotland wanted these other guarantees and protections, it would not be in a position to say that that is not acceptable.

Ruth Davidson MSP: In our very recent history we have had two very big examples of where what we are talking about has come into force: that is, the capital injection and loans that have been required to help RBS and HBOS, the Scottish-headquartered banks that failed. The question I think you were asking was: would a future separate Scotland work on the assumption that the UK's Government would require the UK to help out? Would there be any requirement on the rest of the UK to give that help? Some £66 billion-worth of capital injections and loans were advanced to recapitalise RBS and HBOS. That is 45% or 46% of Scottish GDP. It is a huge amount. If you are asking me to say what the Scottish share of public sector net debt would be, it takes you well past 100% of GDP. Would a separate Scotland be helped out like those banks? I suggest not. Had Scotland been independent, would the rest of the UK have been under an obligation to help? I suggest not. I think it would be down to the rest of the UK Government whether it wished to help a near neighbour. We have seen that in the past the UK has helped near neighbours—I recognise that that has happened—but I am not sure you can risk the financial stability of a future nation on the good will of a future Government of another foreign nation.

Q596 Lord Levene of Portsoken: You talk about RBS, and clearly that is a big player. What kind of regulatory arrangements would you want to see for large, systemically important institutions that are headquartered in Scotland?

Ruth Davidson MSP: As someone who believes that Scotland should retain its place as a strong member of the UK, I would like to see the future arrangements that are planned in terms of financial regulations put in place. As someone who does not support separation, I am not equipped to state what possible future independent regulation may or may not be best. At the moment, with the stability that we have from being part of the UK, from the strength and size of the UK, from the reputation and the trust capital of being based in the UK, as a country that has always serviced its debts, I cannot see an advantage, or a better regulatory regime that could be built in post-independence than the one that we currently have as part of the UK.

Patrick Harvie MSP: Whether Scotland stays part of the UK or not, I can certainly see that there is scope for improving the regulation of financial service organisations, including ensuring that we never again face a situation where we have organisations so big. There is a disease of bigness, which has been part of the problem that has given rise to the culture within those organisations that has caused so much harm. What I would like to see within Scotland, whether that is as part of the UK or as an independent country, is that we move towards a much more diverse ecosystem, if you like, of financial services organisations—small banks, municipal banks, co-operatives—without the market being so utterly dominated by a handful of megabanks. The approach of simply adding one more megabank into the mix is not structural change. I would say that this is about the politics of whichever Government is in charge. Whether they are in the UK or Scotland, they will face the same challenges.

Johann Lamont MSP: It seems to me that it has to go beyond regulation. There has to be a proper recognition of just how reckless and dangerous the decisions that were being made were. To an extent, the First Minister himself was egging on RBS in its purchase of ABN Amro. I am not saying that this is particular to the SNP, but there was a sense that it was not possible that this could not be successful. Indeed, of course, the First Minister said that a problem with the regulatory framework of the UK was that it was gold-plated. I think we all need to step back. I do not think that regulation itself, no matter how heavy it is, is a substitute for people recognising the extent to which we had got into something that was unsustainable. For me, it was a very significant point, the point at which the state had to step in to save the two banks in Scotland. I am not yet quite sure who worked through the significance of that in terms of attitude and the way in which the financial sector operated beyond that role. That is something that, on a cross-party basis, we should be having a far more serious discussion about. Regulation on its own, without changing the mindset, is not the problem. It will just lead us to this problem, regardless of what the constitutional arrangements are.

Willie Rennie MSP: Obviously, I am in favour of UK regulation; I am in favour of the United Kingdom. One of the difficulties with this debate is that we get transitory decisions by the SNP Government about what Scotland would look like for the next 300 years. One of the difficulties is that in the heat of the crisis he was condemning UK bank regulation. Now that that has faded slightly, it is now acceptable for him to say that UK bank regulation should apply in an independent Scotland. He cannot have, on the basis of two or three years, such a radical change in position for something that is going to last us for a very long time in the future. It is that kind of transitory nature of this debate: whatever suits the argument at the time applies. We need to get a much more sustainable, long-term view of how we are going to shape this economy.

Ruth Davidson MSP: If I may add just a very brief note further, I think that we should also be listening to the views of the business community and concerns which have been raised, particularly by those in the financial services sector, on the idea of double regulation. If people are operating not only in Scotland but also in the rest of the UK market, there is the hindrance or financial impact to business of having two systems, both down south and up here. Also in terms of the business community, one of the things that costs investment, time and much more is uncertainty. If you have a Finance Minister in Scotland who changes his position as often as the weather changes, what is going to underpin the financial stability and regulatory framework of the nation going forward? That is a really difficult position for people who are committed to focus in Scotland now, in facing this referendum, never mind beyond it. In terms of pressing for answers, I would be very keen to see this Committee, when the Finance Minister appears before you in London, ask him what his position is now in comparison to what it was two months ago and five months ago. People in the real world, who are not in this room and who will operate the Scottish Parliament, need to know how their business is going to operate in the future and what rules it will operate under. To have that certainty going forward is to everyone's benefit.

Q597 The Chairman: One issue that will obviously be key in the negotiations, if we get to that stage, is how the assets and liabilities of the United Kingdom should be divided up. On what basis do you think that that should be done?

Willie Rennie MSP: This is one of the interesting assertions that the Scottish Government make. They say that we should have a geographical share of the oil revenues and a population share of the bank liabilities. They would pick and choose whatever is of greatest advantage to them, but we need a much more sensible way in which to approach that. There are a variety of different measures that you can look at—spending and population share, a whole range of things. But in general we should be looking at a fair and reasonable settlement, probably based on population share, as that is the best way to proceed. We cannot start making separate rules for different parts of the assets and liabilities, because it takes us into a farcical position, as is shown with the oil.

The Chairman: Is a population basis generally agreed by everyone?

Ruth Davidson MSP: I am not sure that there is general agreement on that. There is agreement in terms of sharing the debt. You can calculate that in many ways, but it could be done by population share or GDP share. They are the two big indicators. There has been some discussion of debt, but there has been very little discussion so far of off-sheet liabilities, which is something that we need to factor into the debate, because those are huge sums. While there has been some small discussion of pensions, we have not really had much discussion of PFI liabilities, which are over many years, or more discrete liabilities, which we have not heard about at all, such as Network Rail debt, and whether there would be a proportion of that. If we are looking at a model for the liabilities that a new separate Scotland divorced from the rest of the UK would have, you have to look at what the position of that nation would be starting out and the liabilities and debt before taking decisions. So there is an incumbency on the people at this table and the people who work in the sector and elsewhere, who have a voice in this debate, to make sure that people really understand the full picture. I do not think that people in Scotland have that yet.

Patrick Harvie MSP: It seems likely to me that both Governments would seek to take a range of attitudes to the basis on which assets, liabilities and debts would be counted. I am certainly not someone who makes passionate speeches at my party conference saying, "It's Scotland's oil", and you would not expect me to, but oil is a geographically specific resource, just as wave and tidal energy will be in future. It would seem odd to say that Scotland would not gain the economic benefit from tidal power in Scottish waters. I suspect that, in the real world, both Governments would try to make their pick of the basis for separating any asset, liability or debt. I would suggest that if both Governments want a fair and honest outcome, some kind of involvement is needed from the international community.

Johann Lamont MSP: I made some points in my paper about the liabilities. To me, this is at the heart of the frustration around this debate. The United Kingdom has through tough times shared resources—human, environmental and economic resources. To me, we do different things at different times; we do not try to find a balance sheet to separate these things off. Geographical happenstance means that oil is in one place and other resources are in another place in the United Kingdom; it is very difficult to unpick the United Kingdom. Those who wish to have independence in Scotland have genuinely said that this is not a liberation movement, representing a Scotland wanting to leave the United Kingdom, but a parting of friends. That negotiation has to be an honest and genuine one, rather than about who can get the best deal. That is difficult, but it will be a challenge in the coming period. I respect what Patrick Harvie has said. If you are going to unpick something that has worked, there has to be transparency of criteria over how we are going to divide things, not the ones that suit you best in that moment.

Ruth Davidson MSP: I know that you have been talking about oil. Yes, you can talk about the geographical share of oil in the seas of Scotland, but what about future expenditure? We have seen a drop of 60% in production since 1999; there are a lot of rigs that need to be decommissioned. We have already heard from the First Minister that he is unwilling to take on the liability for that future expenditure, even though he wants to have the future receipts from the work that is going on in the same area. As for having a specific example, it has been a case of arguing from a particular advantageous point of view to take on the benefits but not to take on the debts, and I think that there has to be a much more transparent way to move forward. We need to have that set out in a way that is understandable to the general public.

Q598 Lord Tugendhat: A question that we have asked before of other people is whether Scotland would be likely to introduce different rates of corporation and personal tax. Obviously, the whole purpose of independence is that there should be differences, but there would be constraints arising from both the relationship with the UK and membership of the European Union.

Johann Lamont MSP: Let me start off by saying that one example of the SNP's key messages about the benefits of independence is that it would be able to cut corporation tax. The benefit of that would presumably be to draw business to Scotland but there is a clear risk that competition leads to a race to the bottom and that the folk who would be benefiting would be those businesses that do not want to pay taxation. That is significant enough within a devolved arrangement let alone in an independent Scotland, where this could involve the Bank of England. The last time the First Minister spoke, he said that there would not be a stability pact, but I think we have to work on the assumption that you would need some sort of agreement. I think that they would have quite strong views on Scotland having the ability to do that. I think they have fairly firm inclinations in the case of Europe as well. Should they cut corporation tax, for example, there are issues around how that would be funded and whether you would have a different balance in terms of the spread of income in Scotland.

Ruth Davidson MSP: It will be no surprise to your Lordships that, as someone who would like to see both income tax and corporation tax brought down across Scotland, this is something that I have looked at previously and spoken about at length. First, it is worth remembering that the Scotland Act 2012, which passed through the House of Commons and the House of Lords, devolves a significant level of tax-changing power to the Scottish Parliament without independence. There is the ability to change income tax significantly. That power comes in Section 26—two years after a referendum, granted—but without independence so we may well see, even within the United Kingdom context, a difference in income tax levels between Scotland and the rest of the UK.

When it comes to corporation tax, the real argument here is on where work will need to be done going forwards. We are already seeing a reduction in this tax across the UK. The Chancellor of the Exchequer said that he would bring it down to 22% by 2015, I believe, with a view to reducing it to a final figure of 20%, one of the lowest levels in the G7. This brings us back to the point I made earlier and where we were yesterday as regards the SNP, the current Scottish Government. The argument about is that we do not know whether a future independent Scotland would be able to set its own corporation tax because we do not know the status—

Lord Tugendhat: Sorry, can you say that again?

Ruth Davidson MSP: We do not know whether a separate Scottish nation state would be able to set its own corporation tax because we do not know its status within the European

Union. There is an aim within the European Union to harmonise corporate taxation levels. We have already seen an agreement between France and Germany to bring it closer together, which is being used as a template for what I believe is called the fiscal compact for the eurozone nations. There is a level of the hypothetical here, but if a future separate Scotland is an accession state to Europe, it would be forced to take the euro and to go into the fiscal compact, and it would have its corporation tax rate set by Europe.

For me, if we are looking for the rest of the UK to be going down to 20% and at the big drivers within the eurozone, France and Germany, having corporation tax rates of 29% and 32%, there will be a big problem for a separate Scotland in competing with its largest market, the rest of the UK, which would now become its largest competitor. There are a huge number of issues here that need to be looked at. A huge number of scenarios could come out of this. Again, this leads me back to a previous point I made about the uncertainty for businesses currently based in Scotland. There will be hugely damaging uncertainty if we do not have the answers to what is going to happen, post a referendum.

Willie Rennie MSP: There is the legal position and there is pressure from the European Union, particularly on corporation tax rates, on whether Scotland would have the freedom to move in future into doing something on its own. But the SNP is not proposing to turn things around. There is a figure of 12.5% but it is likely to be much larger than that. It is also the question of whether we can afford it. I am not saying that Scotland cannot in the best of times wash its face. It can, in broad terms. This year, the SNP is citing figures that there is 9.6% or 9.3% to Scotland's advantage in its spending and income, but that is taking into account that oil is at a reasonably good price just now. If that fluctuates substantially, the position could alter significantly and impact on the ability of Scotland to vary tax rates. The return that the SNP was citing from this small cut to corporation tax would only be felt over many years. It would be a long time before you got an economic return. You would not have the advantage of being the first to move into that kind of low-tax regime, because others will already be there. There are significant challenges for the SNP in terms of affordability and of whether it would be allowed to do these things.

Patrick Harvie MSP: I would be extremely hostile to the proposal that an independent Scotland should start off with a tax competition on corporation tax. Whether it is in relation to the eurozone, as Ruth Davison mentioned, or simply in closing down those loopholes and opportunities for corporate tax avoidance, the case is far stronger for cross-EU co-operation on corporation tax inside or outside the eurozone. On personal taxes, however, the opportunities really are there to do things differently and to have a more progressive and redistributive approach to personal taxation—or in fact to reduce the level of personal income taxes and replace them with geographically specific taxes, such as a land value tax. That is by no means a new idea; I think that the House of Lords was the first body to discover it. No one who was a Member then, a century ago, is on this Committee, obviously. But the opportunity to do that at a national Scottish level—it could be done at local council level but it would be easier and more administratively simple to levy it at a national level—is something we cannot do at the moment. It would, again, have benefits in terms of incentivising particular types of economic activity and land usage, which is much more controlled and much more subject to a Government being able to get policy signals than a simple blanket cut in corporation tax, which, as I say, would simply open up the opportunities for corporate tax avoidance—something which I think all of us should regard as morally indefensible.

The Chairman: We have time for two more questions.

Q599 Lord Forsyth of Drumlean: An independent Scotland issuing its own debt would have no track record in the market. Leaving aside all the uncertainties about who the lender of last resort was, and assuming all those issues were resolved, is it not highly likely that

Scotland would have to pay more for its borrowing than the rest of the UK, or the United Kingdom as it is at present? Have you made any estimate, given the size of the national debt which, by the end of this Parliament, will be £1.5 trillion? Scotland would have to take its share of that. So a few points difference on borrowing rates is a sizeable amount. Has any estimate been made of the impact of that on the funding of public services such as health, social services and others?

Patrick Harvie MSP: You will probably not be surprised to know that I have not made an assessment of that. I would very much welcome the Scottish Government's answer to questions such as that. It is the kind of issue which, with their resources, they ought to be addressing. I would encourage you to put the question to them.

Lord Forsyth of Drumlean: And you would believe the answer, would you?

Patrick Harvie MSP: I would take it into account.

Ruth Davidson MSP: I have not done the workings that Lord Forsyth referred to, but he raises a very good point about the ability of a separate Scotland to service its debt and at what cost. We have already had a senior executive from Fitch, one of the big ratings agencies, come out saying that it has never given a AAA credit rating to a new country. I believe that the Chief Secretary to the Treasury, Danny Alexander, and the Treasury Permanent Secretary, Sir Nicholas Macpherson, have suggested to this Committee in previous evidence that whether a new separate Scotland would be able to take on an AAA credit rating could be an issue. While a lot of the work is on the impact on public services, we have had a look on the impact on individuals. The average digression between an AA and a AAA credit rating is 0.77 percentage points. If you look at how that is passed on to consumers, then the answer for Scotland is £850 a year, and there is no guarantee that a separate Scotland would get a AA credit rating. In preparation, I was looking at examples from around the world. The only example that I could find of a new country that is not impoverished, in some turmoil or in some way exceptional, is Montenegro. In 2010, its first 10-year bonds were charged at 7.85%. Compare that with the UK and it is a big difference. What is also worth noting, in terms of the 7.85% cost of a 10-year bond from Montenegro, is that country at that time had a public deficit of only 4.2% of GDP and a foreign debt of only about a quarter of its GDP, which compares favourably with what one would assume a separate Scotland would have. So in terms of the ability to service debt—not only for individuals but for the state—a separate Scotland would indeed encounter some problems.

Willie Rennie MSP: It cannot get any better than the AAA rating that we have in the UK.

The Chairman: That is a very clear and precise answer.

Q600 Lord Hollick: Whether Scotland is independent or not, it is very dependent on the price of oil, which dominates the Scottish economy. Is there a danger that the oil sector will squeeze out the rest of the economy and draw in most of the investment? Whether it is independent or not, that represents quite a challenge for Scotland. How would you approach that and how would you look at it in terms of how to grow other parts of the economy?

Patrick Harvie MSP: Obviously, I would see this in the context of a transition from fossil fuels to renewables. Ruth Davidson mentioned the decline in production. As a Green politician, it is a matter of regret to me that successive UK Governments and this Scottish Government see the priority as squeezing out every last drop that they can. The challenge for the whole world, including fossil fuel-rich countries, is to find ways to make it economically acceptable to leave a good chunk of the stuff where it is. We have many times more reserves of fossil fuels than the world can afford to burn. Scotland is well placed to find ways to do that. We have this vast renewable energy potential on our doorsteps and investment is happening in renewables. It is not down to the Scottish Government's targets, although it began before that and has been accelerating. We have substantial investment not only in mature renewables such as onshore wind; there is research and development into offshore wind, wave and tidal energy. The challenge for us is how quickly we can do that. How quickly can we scale that up to the extent that we can make it affordable to leave some oil and gas where it is?

Willie Rennie MSP: One of the big opportunities for Scotland over the next few years is how it can maximise renewables potential. The question is how to do that. How do we make sure that we use the financial support to make that happen as quickly as possible? One of the big advantages in the UK is that energy consumers throughout the United Kingdom are supporting Scotland in developing its renewables potential. The Institution of Mechanical Engineers did some work on what potentially would be lost from that extra support if Scotland was to be separated. It is in the order of £200 per household by which energy bills would have to go up as a result of separation. We are effectively relying on English, Welsh and Northern Irish consumers to support the development in Scotland. We would be out of potential renewables if we separated.

Patrick Harvie MSP: Could I add one further point to that? There is going to have to be a new relationship between the two Governments if Scotland becomes independent, not just because of the existing UK electricity market but also because of the continuously developing European electricity market, which involves cross-subsidy between different jurisdictions. The challenge to do that has to include cross-border arrangements. It already does across Europe and it must if Scotland is separate as well. The Economy, Energy and Tourism Committee at Holyrood down the road, of which I am a member, has just finished an inquiry into renewable energy in Scotland. The bulk of the evidence that we have is that those investors who will be vital to development are not being overly put off by the fact that we are debating the prospect of an independent Scotland in two years' time.

Johann Lamont MSP: I would just make the point that in the current set-up we can have negotiations and can ensure that kind of support. We have these cross-border arrangements. What Patrick is saying is that with independence you have to take that away and then everyone will have to re-establish these cross-border arrangements because they make sense with things such as energy. Increasingly, not so much the Green Party but certainly the SNP has emphasised how little will change, and there is an expectation of the good nature of the neighbours, which we have and we share currently, but we do not what will happen in the future. It is almost like breaking and refixing something that is working as it is. On being overly dependent on oil, I think that has an implication for our credit rating and people's confidence in the economy. I do not think that there is anything inevitable in the view that, because we have a strong oil sector, we cannot then develop other parts of the economy. That is a matter of political will and a matter of political priorities. It is about making sure that you diversify. You make a commitment to renewables. You focus on the important stuff such as growth and jobs for people across our communities. That is where the political divide lies, regardless of the constitutional arrangement for Scotland.

The Chairman: That is a very interesting point to finish on.

Ruth Davidson MSP: May I add one small addendum, Lord MacGregor? The SNP Government publish figures every year quoting the revenue raised in Scotland that is made up of North Sea oil—in 2008-09, it was 21%, by the next year it had fallen to 12%. There really is volatility there. Given that the SNP Government are creating instability within the financial sector, which is another large sector in Scotland, and within the past 18 months have implemented £100 million of new Scotland-only business taxes, I do not think that there is any will from the current Scottish Government to grow or diversify that sector of business in Scotland.

The Chairman: That point about the volatility of oil prices and oil revenue has been made to us by many witnesses not just here but in our hearings in London. You have all done an unusual and pretty impressive thing: you have managed to cover as leaders of four political parties, and dealing with very complex issues, answers within an hour and a quarter. You conveyed clearly to us your general views. I realise that we could have gone into a lot more detail, but we got a very good flavour of your general reactions in this hour and a quarter. I admire that and I am very grateful to you. Thank you very much indeed.

Examination of Witnesses

Owen Kelly, CEO, Scottish Financial Enterprise, and **David Nish**, CEO, Standard Life

Q601 The Chairman: I am anxious to begin because I know that Mr Nish has to go at 3 pm. Is that right?

David Nish: It is 3.30 pm.

The Chairman: That eases the pressure. Thank you both very much for coming. In the interests of time, will Mr Kelly begin?

Owen Kelly: Thank you for having us. I hope I can add something useful to the Committee's deliberations. Scottish Financial Enterprise is the representative body for Scotland's financial service industry. We are a private membership organisation. Our members come from all sectors of the financial industry and from other areas of commerce, such as the law, technology and so on. Our membership is very diverse, reflecting the fact that Scotland is the only financial centre outside London where all financial services are available.

We follow the debate about independence very closely, chiefly in order to ensure that our members are fully informed about the possible consequences and implications of such a major change. We are neutral on the question of whether Scotland should become a country independent of the rest of the UK because, in our view, that is really a political question and one for the voters. However, that does not mean that we are disinterested or uninterested in these matters of public policy that affect our industry very deeply.

We have done quite a lot of work on this. We focused our work on analysing facts and evidence that are available now and can tell us what independence would mean in practice. We do not speculate on what might be decided in an independent Scotland, since we do not think that is knowable at this stage, and we treat with caution all assertions on either side of the argument that are necessarily based on beliefs and expectations about the actions in future of a hypothetical polity rather than on hard facts and evidence.

Our work has focused on five key questions which we think are the most important for our industry. They are: what currency would be used? Under what terms would Scotland be a member of the European Union? What would be the effects of independence on what is currently a wholly single market for financial services in the UK? How long would the transition to independence take, should it be chosen? What would be the requirements for financial regulation on the working assumption that Scotland, once independent, would be a member state of the EU? We do not think that all these questions, or, indeed, any of them, can be answered solely by those who propose and are in favour of independence. We think that the decisive voice on many of them will lie elsewhere, chiefly in London and Brussels. I am very happy to share with the Committee our progress in answering those questions and to deal with any other questions that the Committee has to ask us.

The Chairman: Thank you. We will be asking questions about some of them.

David Nish: First, I thank Lord MacGregor and the Members of the Committee for this opportunity to take part in this session. I would like to provide some context for Standard Life's evidence today. Standard Life has been based in the city of Edinburgh for nearly 190 years, and we are very proud of our association with the city. Of course, we are here because this is where we were founded but, importantly, we value the business environment that exists in Scotland, and it is a great place to recruit and retain quality staff. Standard Life is strictly non-political. However, we are monitoring the constitutional debate very closely in order to understand the impact on our 4 million UK customers and our responsibility towards helping them plan their long-term financial security. Constitutional change should not be a risk. We also need to understand the effect of other constitutional changes on our 1.5 million shareholders, many of whom are also customers, and our staff, around 5,000 of whom are based in Scotland. We see degrees of uncertainty on both sides of the debate and, as you would expect, we seek more clarity more quickly. The sort of detail we would value in order better to understand the implications for our customers, both current and future, includes such questions as the future tax policy and how it applies to pensions and investments, how the long-term savings and investment industry will be regulated and the level of consumer protection that we can expect relative to what we have today through mechanisms such as the Financial Services Compensation Scheme and the Pension Protection Fund.

There is also a wider policy issue, which is the role of Standard Life and providers in helping to address the significant level of undersaving that exists in the UK, both north and south of the border. We are currently working with regulators, policy makers and industry associations to deliver a sustainable increase in long-term savings across all sections of society, which has led to the recent launch of auto-enrolment into pension schemes. In the event of any further constitutional change, we would encourage careful thought to ensure that the consensus approach to tackling the problem of undersaving that has been adopted is sustained.

Q602 The Chairman: Thank you. On your last point about undersaving, the issue of the long-term future of pension schemes—defined benefits schemes and so on—is one that many of us in this Committee are concerned about, but it is not one that we can deal with in this inquiry. However, some of the issues you have raised and the questions you want answered are precisely the questions that we will be asking and we will be asking you in return about some of them.

Given that an independent Scotland would use sterling as a currency, do you envisage any arrangement whereby the Bank of England could provide traditional services, such as lender of last resort, to Scottish-based financial institutions? Since the Bank of England is exclusively indemnified for losses by UK taxpayers, how could taxpayers in one country provide financial system insurance to another?

Owen Kelly: I suppose that is one of a number of questions that we probably do not see ourselves as yet being in a position to answer. There are so many uncertainties about how things would work in practice. As I said in my opening statement, we try not to get involved in speculating on what might or might not be decided in future. However, on the specific question of lender of last resort, and if, when one talks about lender of last resort, we mean the provision of liquidity to a solvent bank to deal with a short-term crisis situation at penal rates, it is possible to imagine a situation where the penal rates that are part of that arrangement are a recompense rather than any kind of indemnity. I suppose that is not a million miles away from what the European Central Bank offers to Spain, for example.

On the question of a bailout where there is an insolvent bank and a need to put in taxpayer money, which we have seen with some of the banks based here in Scotland, I think it is extremely difficult to envisage how that could work between two distinct member states of the European Union. We are all aware of the proposal put out by the Scottish Government that there should be a shared central bank and a shared regulator. We would look for more clarity on whether a shared central bank is compatible with the treaties of the European Union, given that they refer explicitly to each member state having a central bank. I am not claiming any special insight into the requirements of the treaties, but we think that is a question that needs to be addressed before we get to the point of figuring out whether it could work in practice to share a central bank in the first place.

David Nish: The only point in Mr Kelly's response that I would seek to emphasise is the final one about clarity about how the mechanism would work, particularly within the broader European framework and the member states. We see a lot of regulation and the structure of legislation coming from Europe directed towards member states. In my experience, it is a key principle that prudential regulation, oversight and the link to monetary policy tend to be jurisdictional and geared towards the country to which entities and corporations are aligned.

That is a very specific question. We need to understand that flow to be able to consider the broader questions that come out of it.

Q603 The Chairman: One of the key questions that we have explored with other witnesses is that if an RBS/HBOS situation arose again, the figures that the British Government would have to provide would be phenomenal and would be a huge proportion of the GDP of an independent Scotland. So there is a very real problem there if similar situations arose. You did not really answer the question about how the taxpayers of different countries would respond. Maybe you regard that as a political or otherwise non-financial question, but there is certainly a very big issue about what could happen.

Owen Kelly: I think the question about taxpayers is a very large one. As we understand the political process that we face, we will have a referendum—that seems to be on the cards—and only after we have had it will we begin the process of answering the questions that, for our industry and many others, are really pressing. That is because, in order to know the answer to some of the questions put today, we will have to go through a process of negotiation not only with the UK authorities but with EU authorities as well and, with regard to many other issues, international authorities. So at the moment we are struggling to see how we can treat the propositions that come from those who favour independence as anything more than contingent propositions, highly dependent on a process that can only follow the point of decision. The thing that we are wrestling with at the moment is the extent of that unknowable territory. "How little informed will we be at the point of decision?" is the question that is troubling us at the moment.

Q604 The Chairman: One of the problems is the timetable. We have quite a long period until the referendum vote. We do not know what the vote will be but if it is a vote in favour of independence, as you say, there will be then a long period of negotiation and a lot of these issues will be very material to your industry and could be very unfavourable to it. Is there any concern that this long period will affect your business?

Owen Kelly: There is a lot of interest, and not just in our industry, in understanding how long that would take after a referendum. We spoke a bit about the pre-referendum process of clarification politically, and I think we all understand why the UK authorities do not want to be cast in the role of negotiating ahead of something. I am not sure that they or the Scottish Government actually have an electoral mandate to agree anything anyway; I do not know on what basis that would happen. I am not sure that it was particularly planned this way by people on either side of the argument, but we seem to be in an odd situation. The European Commission has been very clear that it will not say anything definitive, for all sorts of reasons—we could discuss what they are, but they will be obvious to most people in this room. Initially we had four big questions and now we have five, and one of them is how long the transition would take. It is difficult to get hard facts about that, but one hard fact is that the ratification of the Croatian accession treaty will be finished in July and will have taken 18 months. So even after the negotiation, the ratification process alone can take 18 months, if one takes the Croatian example as a model. It is difficult to see how it could be concluded quickly. I do not want to put a figure on it but I know that claims are made that it could be concluded very quickly, even before a Scottish election in 2016. There are a number of facts that suggest something quite difficult.

David Nish: In many ways, to go back to the points in my statement regarding our customers, and reflecting Mr Kelly's point, some of these macro issues essentially look as if they are not going to be resolved for a period of time. We as a provider need to ensure that we are giving confidence to our customers regarding the sustainability of, for example, the propositions that we are involved in and the robustness of the organisations that we deal with. These are things that are within the remit of the organisation to be able to control and influence. We have said how strongly we will end up taking an active interest as we have been given to develop an understanding of the impact on our consumers and on the propositions and products that they use. So although I understand your comment around pensions and long-term savings, fundamentally we need to ensure that consumers have confidence in the financial services industry long term so that they end up investing for the longer term. That is beneficial not just for them as individuals but for the economy as we grow and invest.

Q605 Lord Hollick: One of the challenges over the next two years is to furnish as much information as possible to the public. Clearly you have many questions that you need answered from your business standpoint. What steps are you going to take to ensure that that information comes into the public domain? Without taking sides in the debate, it seems to me that you need to be proactive to make sure that the issues you are most concerned about are brought to the attention of the wider public so that detailed information about your concerns is also made more widely available.

Owen Kelly: I suppose our primary purpose at this stage is to ensure that our members fully understand the implications and consequences of a vote in favour of independence. One of the few facts that we know—well, we do not know this, but it seems quite likely—is that there will be a referendum. So we want to ensure primarily that our members are as fully briefed as they can be on the facts and evidence that we can bring together along with, potentially, our judgment on what the most likely outcome is, if we cannot find any facts or commitments from the political players, and by that I mean UK and EU authorities. In terms of whether we would then see ourselves as having a responsibility to broadcast them more widely, we are an open organisation and we will be very open about the facts that we find, as we are now—we are happy to speak to anyone who wishes to talk about the various strands of the work that we have in hand. Having said that, your point about not taking sides is very important. We are an impartial organisation and do not seek to take any political decisions, and we will stick to that.

Q606 The Chairman: "Political positions", of course, mean that things that could be harmful to your members are ones that you will be lobbying about.

Owen Kelly: I suppose I go back to the question, "Who might we lobby?" Obviously we have regular and extensive discussions with the Scottish Government, but while their policy preferences on matters important to our industry are interesting, because there will be a number of political parties competing in an election in an independent Scotland under an electoral system that I guess will become clear at some point, I do not feel—although I am very happy for things to unfold differently and for them somehow to acquire the capacity to make commitments for the longer term—that, as I understand the process, they are currently in a position to make those kinds of commitments. So in terms of wanting to protect the interests of our industry, were independence to be voted for, we would be looking to the frameworks that come with the European Union as a constant point—the kind of constant enduring framework within which something like that would take us.

Q607 Lord Forsyth of Drumlean: I do not mean to be rude, but you have 200,000 people employed in Scotland. Do you not have a duty to look at these proposals and evaluate them and provide some leadership as to the impact on your businesses? If you say that after the referendum there will be negotiation and, obviously, you want to be involved in that, if Scotland votes for independence that is irreversible. I do not want to be alarmist, but one could paint a picture in terms of not having a lender of last resort and not having a capital base, which means that your members are unable to raise money in the markets here and move their headquarters south, having differential tax rates, which would have an enormous impact on your savings and pension products, and the rest. One can paint a black scenario—but you sound to me as if you are sitting on the fence, almost behaving like a member of the royal family in the political process, desperate not to be tainted with one argument or the other. Yet financial services are the key thing, apart from North Sea oil, and surely the industry should at least be pointing out the questions that need to be answered and holding the feet to the fire of those proposing change that may threaten your members.

Owen Kelly: I understand where your question comes from. Perhaps I should not reject the comparison with the royal family—perhaps I should accept it gladly. This is a highly politicised process. That goes without saying. Our approach is to focus on facts and evidence that we can ascertain now, and some of those facts that we have discovered through that process carry very evident implications. One fact that we have discovered, which may have been obvious but which was none the less for a time obscured by those who favour independence, was that Scotland would need to have a separate financial regulator. Now we think it is pretty clear under the European regulatory framework that we have to have a financial regulator, so we now have some work in hand to try to figure out what it would mean in practice. As I say, we do not want to make assumptions about what an independent Scotland might or might not decide about financial regulation, but we can look at outlines of cost and other things that will give us a guide for the implications in practice, and we will be quite open about that. If you are suggesting that we should move from there to expressing a view on the referendum question, I think that that is a step that we are not currently taking. I would not completely rule it out in future, but that is not something that we are working towards at the moment. But our pursuit of facts and evidence, and our description of them, will contribute to the debate and make very clear what we factually know the consequences of independence are for our industry.

Q608 The Chairman: Let me give you an example. We are coming on to it in more detail in a moment, but the issue of the lender of last resort and financial institutions could have major implications for your business and your customers. Would it not be right for you to point that out now? Certainly some of our witnesses have.

Owen Kelly: Absolutely. That is one of the many questions that we have raised—with the UK authorities and with the Scottish Government. I am assured by the Scottish Government that they will put something out before Christmas, which they call a macroeconomic framework. It has probably been discussed before this Committee before; it is a group that is a sub-group of economic advisers. They are saying that that is when it will become clear and they will explain how the central bank and so on will work. We look forward to seeing that and we will evaluate it and it may well raise further questions. But I hark back to this—that if one were looking for certainty about how lender of last resort would work, to take that as an example of one aspect of a very complex picture, I am not sure that we could see their assertion of how things could work and their propositions as a conclusive answer. That can come only from some sort from discussion with the UK authorities.

Q609 Lord Tugendhat: We are looking into the implications of Scottish independence for the United Kingdom as a whole. You have Scotland-based Scottish companies, but the vast majority of your clients are in England, Wales and Northern Ireland. We are dealing with a lot of uncertainties, as you yourself said; we do not know what the outcomes will be but we know that some of them will have a profound impact on your business. Do you not think that you have a duty now to begin to inform your non-Scottish clientele and customers of the implications of what is being talked about? I am no longer a policy holder with Standard Life—I am too old for that—but I had a good experience with you earlier. But if I was still one, I would expect to hear from you about the potential impact on my policy of what is happening in your part of the United Kingdom.

David Nish: The key thing that providers such as ourselves should do is to act responsibly towards their customers, and part of acting responsibly is not to get engaged in hypothetical discussions or hyperbole. That is one of the difficulties at the moment. In Lord Forsyth's last question he used the word "proposals", but I am not aware of any clear proposals that go to the heart and allow us specifically to comment or analyse. What we are doing is giving our customers the confidence that we will engage and do engage with the political parties as regards the issues that we see coming through—I mentioned some today—such as financial compensation schemes or the effect of the taxation structure across the UK. One thing that consumers in the UK benefit from at the moment is the consistency of a single geographic market as regards taxation, regulation, employment policy and social policy. I will come back to pensions. We have two major announcements. We will try to bring 11 million more savers into saving over the next six or seven years. It will be government-driven, through NEST, and at the individual pensions level. So one thing that we have assured our customers about is that we are going to be an active participant as the debate develops. At the moment, all we can do is to highlight to the parties and to those who are campaigning the issues that need to be resolved. Some of them go through trade bodies, such as SFE or the Association of British Insurers, at a national level. If consumers want to engage specifically with us, we engage specifically and give out what we know. But engaging in things that we do not know is not going to instil anyone with confidence.

Q610 Lord Tugendhat: I think that you are going to find that the sort of people who write for the newspapers about personal financial advice will start raising those questions in their columns, and the people who read the newspapers and seek advice on whether they should have a policy with you or somebody else will do so. If my personal pension was coming up to maturity now and I had to decide who I would take annuities from now—I had to take those decisions in the past, so I am with who I am with—I would be interested to know the potential position of Scottish-based as opposed to English-based organisations.

David Nish: If I look at the position today, let us discuss prudential regulation. Last week, the Prudential Regulatory Authority—part of the Bank of England, as it will be—issued a discussion paper on insurance regulation. That is framed in the context of the definition of jurisdiction being the United Kingdom. That is the definition that we are all working with today. There is no change to that definition. We focused very strongly as an organisation during the past two years on capital robustness for a recognised format, a recognised customer service. From my point of view, our taking responsibility for paying attention to allowing our consumers to be conscious of the consequences of any constitutional change is what we can do better at the moment.

Q611 Lord Levene of Portsoken: Good afternoon. It has been suggested that an independent Scotland might pay a premium to the Bank of England to provide lender of last resort facilities, just as with any other insurance programme. Do you think that this is plausible? Given the vast size of Scotland's banking sector assets to GDP, do you think that such a premium would have to be enormous? Without paying a premium, how would you expect an independent Scotland to cover the contingent liabilities which inevitably arise from the financial sector?

Owen Kelly: I think, as I explained earlier, that if we are talking about lender of last resort for liquidity reasons, the transaction, if you like, would cover certain costs. To clarify the question, are we talking about bailout?

Lord Levene of Portsoken: Not really, because it would be on an ongoing basis. If it was wanted that the Bank of England stood behind it, one would imagine that, as it would be in another country, it would expect to receive a commercial return for reciprocating.

Owen Kelly: For providing a service. I am not aware of any example of that sort of arrangement.

Lord Levene of Portsoken: Of course, because you would not expect a central bank of country A to guarantee the liabilities of country B.

Owen Kelly: No, I think that is right. I appreciate the desire to clarify these questions. All we have to go on at the moment on how that might be achieved, by any public authority presenting a case for that approach, is that we await the Scottish Government's publication of its macroeconomic framework, where they say that they will explain those things. Like you, I am not able to think of a way to do it myself.

Lord Levene of Portsoken: With respect, my question was: if that were carried out as a commercial transaction, would you expect them to pay a fee and would it be a large fee?

Owen Kelly: I am not trying to evade the question, but I do not know, because it would depend so much on the negotiations that would create such an arrangement. Also, I do not know what model is being proposed because it is yet to be put forward, but in theory I agree with you, it is certainly a major question.

Lord Levene of Portsoken: But your members in SFE clearly regard that as a very important question, as they need to know that they would be backed up.

Owen Kelly: Absolutely, yes, which is why we have posed it in every way that we can and continue to do so, mainly in private, but in public as well.

Q612 Lord McFall of Alcluith: On the issue of financial regulation and the issue of the PRA being a single pan-UK body, David, do you see a difficulty with that, given that the PRA is a UK taxpayer-funded body so that, at the end of the day, the PRA would have both responsibility and liability for institutions in Scotland and could promote recklessness in institutions in Scotland to grow beyond the Scottish tax base because, at the end of the day, the UK taxpayer will be bailing them out?

David Nish: Again, I apologise for not going into the hypothetical nature of the question. As regards my experience of regulation around the world, there appear to be two key principles. One is that prudential regulation tends to be country-specific and specific to organisations within countries. I am not aware of examples of cross-border prudential regulation. You then tend to find that conduct regulation is with the customers related to the market there. So you could have the issue of cross-border legal entities. I look on the question as being: how do you get that alignment between the understanding of what would happen in the economy at large, the policy framework at large and the regulations applying to the entities that operate within it? As I say, I do not have any experience of where that prudential and macro-fiscal policy crosses borders. I do not think that there is a working model that I can find.

Lord McFall of Alcluith: I do not want to get into the hypothetical, but in terms of practical business experience, day-to-day experience, does that make it more difficult?

David Nish: Again, I would prefer to have more straightforward relationships—that is, one to one. If you end up with three in a relationship, you have to work around a triangle. We would need clearly to understand that if there was a proposal along that line—that there would be a derogation from Scotland to the rest of the United Kingdom, as was—it is not just what happens on day one but what happens as the future develops. One thing that is difficult to understand is the stresses and strains that are then placed on the system. There has been experience of that. If you look back over the past three or four years, countries have had to do things to protect entities within their country and their economy. How does that work in a situation where you have a multi-jurisdictional approach? That might add an additional strain, so it is a strong question that needs to be answered: can that be achieved by prudential regulation?

Q613 Lord Hollick: You raised an important issue about cross-border regulation. The proposed European banking union would provide just that. If you look at the non-banking sector, how would you like to see that develop were Scotland to decide to go independent?

How would you like to see the insurance industry regulated so that you as a Scottish-based but international business—I guess the majority of your customers are outside Scotland—

David Nish: Correct.

Lord Hollick: As Lord Tugendhat has said, what would be an ideal? This is another hypothetical question, I am afraid, but what from your point of view would be the ideal and simplest way forward in those circumstances?

David Nish: The thing that is really important is how we ensure that end customers are confident in the organisations that they end up transacting with. That is where this whole thing lies, ultimately, with prudential regulation. Customers today understand that businesses such as ourselves are regulated; they understand that there is an oversight regime, and that there are mechanisms in place that we can go to if they have issues with organisations, whether that is the Pensions Regulator or the Financial Ombudsman Service. So you have to ensure that what is in place is a full framework that takes the end customer very much in mind. This is obviously not me talking about Standard Life, but certainly over the last three years it is very much the individual man in the street who it ends up having the greatest impact on, as regards failure in the financial system. In constructing financial regulation, you have to take account of how the corporate aims are surviving, in the context of living wills, and so on. But it has to be about how you ensure that the individual is confident when contracting for the longer term. So there needs to be real clarity over rules and an ability to see direct access—how the customer can get access through to resolution of particular issues. There has to be this alignment between prudential and conduct regulation; you cannot have one without the other. I agree that what is happening with European banking at the moment is that we are trying to put in place a cross-border situation, but you are also seeing in the early days some of the issues around trying to do it cross-border. You have to take into account the local situation and the impact on the economy locally versus the macro picture, and we have not had experience of operating that way.

Lord Hollick: Your competitors are based to a large extent in London, so would you be comfortable with a situation where you had a different regulator or would you prefer to have the same regulator?

David Nish: I have different regulators all round the world, in a sense, in the markets that I do. What I benefit from today is from having a single regulator in a geographical area. The issue is the change and the impact of the change—and because the definition is not there. Again, when we look through the whole range of things affecting the individual customer's decision, whether it is regulatory oversight or the tax regime, with the introduction of differential tax, or doing it cross-border, the proposition, when one is put forward, has to be very comprehensive. A lot of these things are not just single issues around whether there is a sole prudential regulator; it has to effectively cut across, particularly in the savings agenda. It is about social and employment policy as well as regulatory issues.

Q614 The Chairman: I am being very naive about this because I have not really thought about it very much, but does that mean that the vast majority of your customers in the rest of the UK will ultimately be dependent on the view that they take of the prudential regulator in Scotland and how it manages your business?

David Nish: There are two things that our research of customer needs have shown consistently and strongly. One is satisfaction of expectations, and the second is the robustness and sustainability of the organisation they transact with. These are relationships that take place over multiple decades, so we can see it from the point of view of the individual having confidence in the organisation. That is why I look on the potential consequences of the constitutional debate as it goes forward as being very much about these two things—the confidence of our customers and the competitiveness of my business.

Therefore, as the proposals are developed, we will be able to understand better the impact on those two issues and the actions that will need to be taken.

The Chairman: In terms of the financial compensation scheme, and in the case of a split between the rest of the United Kingdom and Scotland, would your customers in England be dependent on a financial compensation scheme in Scotland or would it be the existing one?

David Nish: Again, hypothetically, if you look at the businesses that exist in Scotland that have such a long history, I do not know how you would end up separating those businesses. Again, it is a very similar type of discussion as the one about having cross-border regulation. You would need to evaluate how such schemes would be established. These schemes are paid for from the industry; they are socialised costs. So to be able to evaluate that, you would need to evaluate the financial services industry on one side and the premiums collected relative to the base of business that the schemes have effectively been guarding against.

Q615 Lord Tugendhat: Just briefly reverting to a previous line of questioning, I have great sympathy with you in your position, as you are running very complex businesses. You have customers all over the United Kingdom and all over the world, and you have a lot on your plate. Uncertainty is a very difficult thing to have to deal with. But the more I listen to you and the more I hear you say what you do not know—and it is not your fault that you do not know it—and the more I hear you saying how important the issues are that you do not know and how profound the implications are of what you do not know for the customer, as somebody who is not Scottish and not resident in this country, it would make me pause for thought before doing business with you for my long-term financial commitments as compared with a company, whether based in London or Canada or elsewhere, which I reckoned did know about these important things. I think that you are being put at a real competitive disadvantage.

David Nish: I would hope in a sense, particularly given the attention that we pay to the consumers' advisers, that what we very much focus on is getting across that strength. Jurisdiction is only one thing that gives rise to the confidence that someone would have in an organisation, and the sustainability that you end up with. So it is very much about us being very mindful of this debate. On the questions that are being asked, I look on a lot of these as the duty of politicians to define the environment in which companies operate. We are very much trying to work in support of a consensus policy that is quite fundamental. So it is a duty on politicians on both sides to get some definition here around some of these big questions, which have been in existence now for at least the last 18 months.

The Chairman: The initiative is coming from one side, of course.

Q616 Lord Forsyth of Drumlean: I do not want to break ranks with the trade union of politicians, but I suspect that quite a lot of politicians may not have the expertise or knowledge not just to answer the questions but to determine what they are, which goes back to the point that I made about providing a lead. At Standard Life, what kind of costs do you have in meeting regulatory and compliance regimes now?

David Nish: I do not have that specific answer, but I shall take that question away. One reason why this is quite difficult to do is that everything we do is regulated. If you allocated parts of my time in the past week, you would find that I probably spent 20% of last week in engagement with regulators. So from that point of view it affects everything that we touch and do, because that is very much the environment in which we operate. I will try to give a thoughtful answer.

Lord Forsyth of Drumlean: You can see where I am going with this. As I understand it, if Scotland were an independent country and it had joined the EU, it would be required to have its own regulator. It would be contrary to EU law for Scotland to have a shared regulator. I see heads nodding in agreement. That would mean that you would end up with two regulators. One of those regulators would relate only to a small proportion of your customers because they would be beyond the Scottish border. I do not know about nationalised companies, but I do know about banking. In banking, the costs of compliance with regulation are absolutely astronomical and compliance officers seem to have become the biggest growth industry of the past 10 years. That presumably would mean that you would see a substantial additional burden to your costs. Would that not make you less competitive than firms that are based south of the border with only one regulator serving where the bulk of your customers are? If that is the case, would there not be a gravitational pull to take you across the gradient that is represented by the Scottish border and therefore to move operations south?

David Nish: As I said to begin with, there are only two real criteria I am using to assess the ongoing debate. One is the confidence of consumers and the other is the competitiveness of Standard Life. The competitiveness of Standard Life will be considered across a whole range of potential metrics that include the costs of doing business. I cannot prejudge at the moment, but we have no desire to go through a large restructuring. In some ways we have experience of that from six or seven years ago with the demutualisation. It was an expensive business because changing anything is an expensive business. As an example, under the Scotland Act, if there is a local income tax, we would have to deal with potentially a local state pension deduction. That could easily be a £2 million to £3 million bill on IT for 250,000 to 500,000 pensioners' operating costs each year. All these things would be taken in the round. It has to be in terms of the costs of change versus the question of whether there is a benefit attached to divergence. At the moment the evaluation of these matters cannot be done. All I know is that change tends to drive up costs.

Q617 Lord Forsyth of Drumlean: Just on the point of costs and the regulator, while I do not want to open up old wounds I seem to remember that, with Standard Life, the FSA took a particular view on how you should organise your business, which I think did a degree of damage to you. So it is not just the costs of compliance. If you have more than regulator, they may have a difference of view on capital requirements or what is going to happen in the market or what the right balance of investment should be between equities, bonds and so on. Does all that not make your business less competitive? Is it affecting value in terms of your ability to raise capital because it creates more uncertainty for those businesses that are based in Scotland?

David Nish: As I have said, the more you introduce complexity, the more likely it is that costs will increase. That is one aspect of the competitiveness debate. What the impact would be on the rest, I would have to speculate, and I am not going to do that. At the end of the day this is something that we will keep under review with close supervision. We are going to take account of it so as to ensure that we are giving our customers best value. As you raised Standard Life's past, hopefully the Committee will recognise that in the past six or seven years since demutualisation we have been recognised as one of the strongest capitalised within the sector.

Owen Kelly: Could I briefly add something? The point Lord Forsyth is making about the additionality of the regulator is important in that if a large proportion of your customers are in a future market comprised of England, Wales and Northern Ireland, you still need to be regulated there. If you have also a regulator at home, it is additional. That is an important point. We are working now on trying to assess the implications of that in terms of costs.

I would also point out that our industry is very diverse. There are different kinds of operations which are affected in different ways. For example, let us say that you are in the business of fund administration or asset servicing and you have an operation not only in Scotland, but also one in South Africa, one in Dublin and one in Hungary. If you want to make some assumptions about the future fiscal and regulatory choices made by an independent Scottish Parliament, it is possible to imagine that it might not make all that much difference because the regulatory jurisdiction you are operating in is not so central to your business model. Another aspect worth touching on is that at the moment the FSA requires some operations to be in the jurisdiction. For example, if a Spanish bank owns a big UK business, it has to have certain things in the jurisdiction governed by the FSA, so again it is likely that you would see some pressures for reconfiguration if a new regulatory jurisdiction was introduced. As I say, we think that under the EU regulatory framework, that is a consequence of independence.

Q618 Lord Tugendhat: The possibility of a referendum has been in the air for a long time, and of course the victory of the SNP in the last election made it a certainty. I am sure that you have had an opportunity to look at the experience of other countries. In particular, I wonder what conclusions you might draw from Canada. My impression is that there was quite a migration from Montreal down to Toronto and elsewhere, and I do not know if Montreal has recovered the position it held before. Would you have any fears that such a situation could occur here in terms of the uncertainty we have been talking about? That obviously must be a great concern to you. Might it provoke something similar to what happened in Canada?

Owen Kelly: I think I can say quite safely, in relation to our members' focus right now, that although people may get impatient with us, it is a question of looking at what you can do to find out the facts and the evidence that will allow us to understand the implications and the consequences. Depending on what those facts and evidence tell us, it is theoretically possible that that could lead to certain conclusions being reached, but at this point I do not think that any of our members are reaching views on that sort of subject. I must admit that while I know a little about the Canadian experience, I do not know a sufficient amount to judge what was known in advance of that referendum. I just do not know if it was a vote on a clearly defined prospectus or whether there was a degree of uncertainty in it.

Q619 The Chairman: I know we have to finish very soon but, just reflecting on the discussion that we have had, I can quite understand your desire to have clarification, particularly from the Scottish Government, as to their views and what they would wish to negotiate for in terms of a number of the issues that we have discussed, but, as I understand it, that is not going to happen for some time. I would have thought that you would have to have a clearer view and be pressing the Scottish Government in particular—since it is their initiative—regarding the kind of solutions that you would like to have to some of the issues that you are raising.

Owen Kelly: Actually I am not sure. As I think I said before, we thought that the Scottish Government would provide the authoritative voice on many of these questions. If one thinks about—it has been in the news over the past couple of days, of course—the question concerning the terms of entry to the European Union, the great debate there, among many other things, is whether Scotland, if it became independent, would inherit the UK opt-out on the euro. That is specifically regarding entry. It seems to me that the authoritative voice on that will be the member states of the European Union. I have put it to UK Ministers that they might engineer a way of obtaining a clear steer on that question from the authoritative voice. The Scottish Government, it seems to me—I venture this as much on a personal basis as on anything else—are clearly wholly committed to winning the referendum. So whatever they say, one has to see it in that context. It is aimed at persuading—and I think, to be fair, that they might agree with that—rather than presenting an authoritative, conclusive and factual conclusion. It seems to me that that can come only from the EU and, on some issues, from the United Kingdom Government. I would not want you to think—in fact, I would reject the thought—that we are waiting for the Scottish Government to tell us things, because I struggle to see how they would have the authority to do so.

Q620 The Chairman: I was not going to ask this question but, in view of what you have just said about the time you have recently been spending in the EU, I shall do so. The reforms being discussed in Europe, including a single financial regulator, market reforms and access to emergency funding from the ECB, are likely to strengthen the case for an independent Scotland becoming a eurozone country in the near term, because you would have those certainties of them sharing a common central bank rather than having to depend on the Bank of England. Is that a ridiculous thought?

Owen Kelly: I certainly do not think it is ridiculous. Obviously people are working in Brussels and talking from Brussels, so they will present the view that in a few years' time everything will be sorted and the euro will be a highly attractive proposition, with everyone queueing up to join. However, a decision like that could only be taken after independence.

Q621 Lord Levene of Portsoken: This question is really of interest to Owen Kelly, for reasons which will be obvious. I want to go back to the question you were asked before about whether you, as the trade association for the financial services industry, which is the first or second industry in Scotland, should not be much more forthright in standing up to be counted. I can understand why an individual firm would not want to do that, because they might see some backlash. But if this decision goes—from what you have been saying this afternoon—the wrong way, it is irreversible. After that, if your members say, "Oh dear, we've got a terrible problem. Why isn't anything happening?" you might say, ""Well, you asked us not to say anything". Is nobody asking you to stick your head above the parapet?

Owen Kelly: At this stage, people are asking us to find out facts and get any answers that we can so that we know, as clearly as possible, what the consequences will be. I am sure you will be much more familiar with this perspective than I am but, from the point of view of a company that, say, is perhaps not even a UK company, there are ways of managing a situation like this that need not involve taking a public stand of any kind or indeed expressing a clear view at all. So in answer to your question on whether we are under pressure to take a stand, I would argue that we are absolutely taking part very publicly and very fully in the debate but on the basis of pursuing questions and obtaining facts and evidence. I again emphasise that we do not solely direct those questions at the Scottish authorities.

Lord Levene of Portsoken: So thereafter you can come back for a second bite at the cherry, if you want to, when you have all the facts.

Owen Kelly: Possibly, yes.

Q622 The Chairman: Or possibly that is too late in the sense of, rather than just asking questions and trying to establish facts, putting forward very clear recommendations as to what is in the best interests of your industry in terms of the policies to be pursued in the context of a yes answer.

Owen Kelly: In terms of participating, if there is a vote in favour, many of us will want to participate in the decisions that follow from that.

The Chairman: I know that Mr Nish has to go. Thank you very much indeed for being with us. It has been a very interesting session and it has given us lots to think about.

Examination of Witnesses

Elspeth Orcharton, Director of Corporate and International Taxation, ICAS, **Jeremy Purvis**, Reform Scotland, and **Professor Jim Gallagher**, Nuffield College, Oxford

Q623 The Chairman: Welcome and thank you very much for coming. I think that this is our final session, so we are not under quite the same time pressure. It has been a very interesting day. Do any of you wish to make a statement, or are you ready to go straight into questions?

Professor Jim Gallagher: I think that we are ready.

The Chairman: Let me start with a question that we have been debating through the day; it would be interesting to have your views. The SNP has said, at least for the time being, than an independent Scotland would continue to use sterling. What do you think would be the best currency option for an independent Scotland, from both a Scottish perspective and that of the rest of the UK?

Professor Jim Gallagher: This is an example of one of the many questions about independence that is inherently unknown. It is unknown for two reasons. First, whatever the present Scottish Administration say, they may or may not be in government in an independent Scotland if such a thing is created. Secondly, these things would depend on negotiations with someone else—in this case, in particular, the UK Government. From a purely economic perspective, there is no doubt that these islands, particularly the island of Britain, are an optimum currency union. It has all the characteristics. It is a single market. Labour moves and capital moves. From that perspective, having one currency makes a lot of sense. But that produces all sorts of difficult governmental questions to answer, some of which I know you have explored with previous witnesses.

Jeremy Purvis: Reform Scotland and the Devo Plus group have not been basing our primary research on what the direct consequences of independence would be. We support the continuation of the UK and the strengthening of the Scottish Parliament and governance within Scotland within the UK. It may help the Committee to know that in my former role as a Member of the Scottish Parliament I served on the Finance Committee. In 2009 I wrote to the Governor about whether or not any representations had been made by the Scottish Government at that point with regards to the future currency under the then Scottish Government's plans for having a separate currency. The reply that I received, which I will supply to the Committee if it is of interest, was interesting. He reiterated to me that they operate under the Bank of England Act 1998, which, among other things, is for maintaining price stability and, subject to that, for supporting the economic policy of Her Majesty's Government. That draws the very clear case that, if the Scottish Government's position is to use sterling, then the economic policy of Her Majesty's Government may not be the same as the economic policy of a subsequent independent Scotland. The currency under which that country would operate would be run in terms of the economic policy of what would effectively be a different country. The Governor went on to say, "It would be a matter for an independent Scotland to decide whether it wished to continue to use sterling as its currency on this basis. It would not be possible for interest rate decisions to take account of inflation in an independent country with its own fiscal policy, in the absence of a proper monetary union framework". Our perspective comes from having decisions made in the Scottish Parliament on tax and finance more closely linked with the current devolved areas of expenditure and policy, and this would draw some strong consequences to what the fiscal policy of the Scottish Parliament would be, even though the framework would be set by a different country. So while the First Minister has indicated his view of what an optimum currency union would be, in my view there would be consequential, and in many ways potentially significant, decisions on fiscal choices over and above what would be in the monetary union with regards to the pursuance of an economic policy of what would be a different country. It therefore is not something that we would support.

Q624 Lord Tugendhat: Many people argue that Scotland maintaining sterling would mean that one would have to enter a fiscal pact. In a sense, it would be like two people in the same bed having to share the blankets and not take up too much space, one of whom is bigger than the other. I wonder how you think this would work and how much freedom of action you feel it would leave the smaller party?

Professor Jim Gallagher: Shall I start on that one? The image will stay with me for a little while. The lesson from the current European difficulties with their connection to monetary and fiscal union is plain as a pikestaff; there is no doubt about that. Therefore, if the rest of the UK were to enter into a monetary union with an independent Scotland, it would have to consider the terms on which it was willing to do so. It would have to take that decision in the interests of its citizens and not those of Scottish citizens. What constraints might it wish to place? The first issue is really about the share of the blanket, as you put it. That is: how much of a deficit is the larger country prepared to allow the smaller country to run without feeling that there is going to be an effect on its currency? You might argue that the other could run as much of a deficit as it liked, because it could go bankrupt and the markets would punish it. I think that if I were sitting in the Treasury, I would say that there is always a risk that the markets will think that we will feel obliged to stand behind an independent Scotland, and therefore the amount that it borrows is inevitably of interest to us. Some constraints on tax and spend are inevitable, I think, in this entirely hypothetical situation.

The interesting question, therefore, is, first, to what extent are those more demanding than the constraints which the Treasury place on Scottish public spending just now. There is no reason for them to be any less demanding, because the Treasury is no longer subject to any political pressure from Scottish MPs. The second part of this interesting question is whether, in those circumstances, the rest of the UK also wishes to argue for some constraint, not on the balance between tax and spend but on particular taxation. That is to say, are they interested, as a condition of monetary union, in reducing the possibility of tax competition? We have not seen that in Europe yet, although there were very strong hints at one point, when Ireland was being subject to a bailout. Governments, particularly that of Germany, were inclined to demand that the Irish policy of low corporation tax should no longer stand. It did, in the event; but it was not a surprising thing for the Germans to think about. The question for the UK is whether it would prevent a similar tax move.

Q625 Lord Tugendhat: The Irish position is interesting. I suggest to you that the Irish introduced a tax policy that has proved very successful. It has caused a lot of resentment among others. Others have tried to take it away from them, but they have kept it. It would be very difficult for somebody else to do what the Irish have done. The Germans, the French and others do not want to have a second one. The example of Ireland, paradoxically, will mean that it would be more difficult for other people to go down that road, because they have seen the advantage that Ireland has gained.

Professor Jim Gallagher: To respond usefully to that, there are many reasons why no other country would or will go down the road that the Irish have gone down. The first, certainly in the context of Scotland, is that it already has a substantial corporation tax base, which Ireland did not have at the time. Therefore, cutting corporation tax by half, which is the kind of thing that you would have to do to make the same reform, would have such a deleterious effect on the revenue that it is not all that pleasing a prospect anyway.

Q626 Lord Forsyth of Drumlean: To pick up the point that you made, Professor Gallagher, about how there would need to be a set of rules agreed between the two Governments in return for an independent Scotland using sterling as its currency, can you help me with two points? First, what would be the stick that would be applied? What would be the sanction? How would you enforce those rules? We have heard a pretty vivid illustration of how successful the Maastricht criteria were in respect of the single currency in Europe and even, in the case of Greece, how, with some help from Goldman Sachs, the Greeks were able to disguise the extent of their variance from the criteria. So what would the sanctions be in order to make this work? At the end of the day, if an independent Scotland wanted to use sterling as a currency and did not want to sign up to any deal or agreement, what is there to stop it?

Professor Jim Gallagher: It is easier to answer that question by dealing with the second half first. The answer is: nothing at all. What you might call the Montenegro option of dollarisation is open to anyone, but it is open to anyone who wishes to operate without a sophisticated financial system. This is what broken economies do. They allow somebody else's currency to circulate in their area. It means that they can do without a central bank. They do not need a central bank; they simply allow dollars to circulate in their territory. They do without, and certainly do not seek to operate, sophisticated financial services systems that try to sell to the dollar area. Panama is a fair example of that.

Lord Forsyth of Drumlean: Sorry to interrupt, but can you develop that argument as regards what the consequences would be for Scotland, and then deal with my first question?

Professor Jim Gallagher: Certainly. If Scotland wishes to use sterling, one option is what is in the jargon called "dollarisation"—simply allowing the currency, sterling, to circulate in that area but not having a monetary policy of your own. If you do that you do not need a central bank because you have no currency with which the central bank would deal, but it is very hard in those circumstances to have a functioning financial services system which relies on all the promises made on liquidity and which you would have from having a central bank of your own. That is not a viable option for a country that has an outside financial services sector. So dollarisation, although conceivable, is not realistic. So if you are going to use sterling, you are back to having a real monetary union. We do not have all that many examples of functioning monetary unions. The euro is a half-functioning monetary union; it is not complete. I think that one can probably go back to the Austro-Hungarian empire, but my knowledge does not stretch that far back. Apart from that, how central rules would work in a monetary union with two independent countries, nobody knows.

Lord Forsyth of Drumlean: I am interested in how they would be enforced.

Professor Jim Gallagher: Indeed, and so would I be in the circumstances. It is not at all clear how they would be. It is certainly the case that if there were to be a single central bank, rather than two central banks in a monetary union—of course there could be more than one central bank in a monetary union, as in Europe—presumably some of the levers that it could pull could be used for enforcement, and you could deny the Scottish Government liquidity. However, no one has thought this out—and I certainly have not done so.

Lord Forsyth of Drumlean: Without putting words into your mouth—

Professor Jim Gallagher: You would never seek to do that.

Lord Forsyth of Drumlean: I have in the past. Without putting words in your mouth, this idea of a fiscal agreement would essentially not be very different from the kind of relationship in the old Scottish Office days that one had with the Treasury, whereby you had to agree with it the extent of your borrowing and various criteria, and you had flexibility within the parameters to decide what your priorities were. Would it really be very different?

Professor Jim Gallagher: It could be different in two respects. First, I think the parameters would inevitably be wider. Secondly, they would include taxation as well as spending. Nevertheless, it is I think inevitably in the interests of the rest of the UK in a monetary union to be clear about how much borrowing an independent Scotland was doing.

Jeremy Purvis: I could certainly foresee a situation that could be worse than the former arrangement with the Scottish Office and the current arrangement for the establishment of block grant, because of the points that Professor Gallagher indicated. If the requirement still pertained with the Bank of England for setting monetary policy for prices and inflation, it would also be looking at what impact Scotland would have on that for the rest of the United Kingdom, and any monetary union would require the restrictions to be upon Scotland as regards the impact on the rest of the United Kingdom, not on Scotland. The interests of the Bank of England as regards its statutory framework would not single out Scotland. Therefore, the consequences of setting budgets, when it comes to making fiscal choices rather than spending choices, would add that extra element as regards the impact of inflation on the rest of the UK. When it comes to looking across the whole suite of what the impact of taxes could be—corporation tax on the financial services sector, on energy and other elements—they would affect prices across the whole UK. We are still waiting for clarity in what the First Minister has outlined by saying, on the one hand, that he agrees there would be a fiscal pact but, on the other, that there would be a voluntarily entered-into agreement on monetary union with what effectively would be another country. We are still awaiting details and clarity as regards his indications on that.

Q627 Lord Forsyth of Drumlean: What impact do you think there would be from having different tax rates in Scotland and the rest of the UK? Also, how much scope is there to have differential tax rates, given that we have just, probably, agreed that there would have to be some kind of fiscal rules? To what extent would it be possible to have differentiation in tax? What would the administrative impact be? What would the impact be on financial services, savings, pensions and so on?

Elspeth Orcharton: If there are different tax rates in Scotland, either corporate or personal, we start by asking, “Different higher or lower?” We do not have any information about what the tax system for an independent Scotland would be. That would be driven by three things. The first is the expenditure side. What does Scotland need to raise in tax revenue to fund this expenditure? We do not know that at this stage. We do not know what the taxpayer base in Scotland actually is, although there are some derived statistics and approximations that HMRC has been able to extract from its information and statistics. We do not know what tax system would be adopted. At a very high level, we do not know what the split of direct and indirect taxes might be, and we do not know what our replacement for national insurance contributions might look like. If you look across the EU, there are wide variations in how tax systems are put together. All these things are features that need to be taken into account when considering tax reliefs. I do not think we should lose sight of the fact that those options, choices and calculations are still to be determined.

As a working assumption, if we had a tax system in an independent Scotland very similar to the one that applies at UK level, we do not know what the choices of the Government of the day would be. We could speculate that there may be a proposal to introduce lower corporate tax rates, assuming that the spending side could somehow be managed. We then have to look at the consequences of that for businesses, and they can be twofold. One is that there may be a movement of businesses into the lower tax regime in the same way that around the world at the moment businesses will look at their supply chain and the location of their business operations. There is a competitive market in corporate tax rates, so there could be effect on business.

The larger one, which perhaps has more administrative consequences than solely economic ones, is moving profits between business locations where there are already operations across the UK. There are profit-shifting opportunities, without moving the economic fundamentals, so the argument is that a profit arises in a lower tax jurisdiction than a higher one. That would mean that businesses operating across the UK would have to do something that they do not need to do at the moment, which is to be able to demonstrate to their corporate tax authorities and exchequers the basis on which each exchequer is getting a fair slice of the tax on any profits realised in those jurisdictions. At the moment, for example, there are considerable exemptions for small and medium-sized enterprises in the UK system. It is entirely open to speculation as to whether that would need to continue, or whether it could not, given that there are a number of large businesses—take a retail chain, for example—that are operating right across the UK that would have to go through an administrative process.

The only other point is about individual tax revenues raised. We know from some of the statistics that the Office for Budget Responsibility has produced that, from an income tax perspective, there is a slightly lower income distribution in Scotland when considered relative to the rest of the UK, meaning that there is a relatively lower proportion of Scottish income tax payers paying tax at the higher and additional rates. If that slice were to be taken out, that may have an impact on the tax revenue realised once you have separated the taxpayer bases.

Q628 Lord Hollick: Could we come to the question of how assets, liabilities and debt are divvied up in the event of independence, including your thinking on how oil reserves are divided?

Professor Jim Gallagher: Again, on the assumption of independence, there would have to be a sharing out of assets and liabilities. There is a simple start, which is geographical. At a very simple level, most assets which are within the jurisdiction fall to the country in which they are. Physical public assets—government buildings and so on—are easy to do. It is pretty plain that there is now an acknowledged likely international or consistent boundary at sea which would determine which country most of the oil fields fell into and therefore which country would have the opportunity to tax them. An interesting question there is the extent to which the promises that have been made to oil companies about the tax relief that they will get on decommissioning those platforms will be carried across into an independent Scotland. If that does not happen, Scotland would find itself with a lot of undecommissioned platforms and the problems that that can produce.

There are lots of non-real assets that would have to be split up. The most obvious one is the UK's national debt, which, if I recollect correctly, works out at something more than £30,000 per household. On what basis would you share it out? I can imagine three possibilities. The first is on a historic calculation of who had benefited from it, which would be jolly difficult to do because there would be arguments about who had benefited from the spend and contributed to the tax. The second is a straightforward population share, which is probably the most likely. The third is what you might call ability to pay: the proportion of taxable capacity that was moved from one jurisdiction to the other. That is where oil is relevant because at the moment, if you believe the estimates in the Scottish Government publication GERS, Scotland, although it has 8.3% of the population, has 9.3% of the tax revenue if oil is included. So, if you went on ability to pay, it could get a larger share of the national debt.

However, there are lots of other liabilities, the most substantial being unfunded public sector pensions. How do you share those out? Again, one might argue for who has the benefit of the public service, or, following that argument, where do they live, or one might argue for a simple population share-out. There is a whole host of PFI obligations, some of which are geographically fixed and some of which are not. There is a whole host of contingent liabilities, such as the decommissioning costs of nuclear power stations and so on. All those would have to be shared out in a broad negotiation. That negotiation would have to take account of just about everything within the Governments, and there are many issues on which the Scottish Government could be the demandeur in that negotiation, just because of the dynamic of the situation and the scale of who was asking for what. However, there are some cards that it would be difficult to play in a negotiation like that, the most substantial of which is what happens with the defence assets, notably at Faslane and Coulport. So it would be an enormously complex negotiation.

Q629 Lord Hollick: Are there any precedents that you can point to which would help those discussions to be navigated satisfactorily?

Professor Jim Gallagher: The only recent precedent that I am aware of is the split of Czechoslovakia into the Czech and Slovak republics. It was simpler, in that those were two genuinely federal republics. In principle, the assets of the jurisdiction were followed. The national debt was not very large, oddly enough; it was a communist country and only borrowed from itself. Even at that, the negotiations ran to some 3,000 agreements, not just for money, and there are still 500 initiatives there.

The Chairman: So the conclusion that you draw from that is that if we went down this route, it would take a very long time to reach agreement.

Professor Jim Gallagher: In reality, I do not think that it would be possible to conclude the negotiations for years and years. I think they would have to come to some kind of deal, after the next two years, and realise that there will be substantial things for many years after that.

Jeremy Purvis: Of course, there are many assets which are, even now, publicly accounted assets, but they are currently in private operations. That adds an extra element to the consideration; private parties may well have funds that are an asset. That adds an extra complication. It is not necessarily a case of intergovernmental agreements, but there are things on top of that. If you think it is appropriate, at some stage we could give an observation in response to Lord Forsyth's view on this question of tax flexibility.

The Chairman: You might do it now.

Jeremy Purvis: First, I entirely endorse Ms Orcharton's point. We have written to both the Treasury and the Scottish Government, calling for much greater clarity about what the tax yield is within Scotland. There are many areas of taxes in the GERS documentation that are extrapolations from the UK figures, not actual yield. We make the point in our report about corporation tax that the Holtham Commission in Wales has done some very good modelling. You can draw different conclusions depending on how you calculate corporation tax, whether on economic activity in Scotland, which is the Scottish Government's default position, or whether on businesses that are legally located in Scotland. No modelling has been done with regard to that, to our knowledge, so it harms the debate somewhat. We certainly think that for much more informed decisions to be made in advance of the referendum, there should be more clarity from all sources and from both Governments. We asked for the OBR to have oversight of the presentation of that information. We think it is very important that there is independent presentation and verification of that data.

The final point that I would make in regard to tax flexibility is that, if there are cases for the devolution of further taxes in Scotland, then we are aware that taxes have a somewhat disproportionate impact on what the Scottish budget would be. For example, income tax is 20% of what the Scottish budget would be; corporation tax 6%; North Sea oil and gas would be 16%—a massively volatile source of income which would have, therefore, a massively disproportionate impact on the Scottish budget and business, given the instability in that. When we calculated the standard deviation of the sources of taxes in the GERS documentation, that informed our thinking of what appropriate taxes would be devolved to meet our wishes to have greater accountability for the Scottish Parliament with the responsibility for raising most of its revenue, but within the context of seeking as broad and as stable a source of finance as possible so that the decisions made in adjusting tax are part of policy choices and are not made because of having to counteract economic instability.

Professor Jim Gallagher: Could I add something? There is a general view and understandable principle that varying any taxation is a distortion of market activity. Varying tax across the territory is a greater distortion. One of the great strengths of the UK is that it is not only a single market but a state market. Therefore, a perfectly good argument can be made that one should restrict the extent of tax variation. I know there is a view that across corporation markets decisions will be made for taxation reasons rather than pure business reasons. That said, you might say of businesses, "Well, they would say that, wouldn't they?" If Scotland were an independent country, it would have to make these sorts of taxation decisions and they would have an effect on the market. The market is full of these things. An example of an extraordinary range of tax variation inside a single country is possibly illustrated by Switzerland. It is not a system that we would follow, but there are immensely large variations in personal taxation and, in the end, the markets adjust to that.

Q630 Lord Forsyth of Drumlean: They also have permanent referenda, as I recall. I just wanted to make this point to Mr Purvis, which is that this question of yield is crucial. I do not know if you want to comment on that. One thing that strikes me about the yield argument is that it is not just about revenue, because there are differences. I think we had some evidence in this Committee that shows that the demography of Scotland will be very different from that in the rest of the UK. We will have a much more ageing population, which will affect the demand side of public service as well as the revenue side and will make a substantial difference. I do not know whether anyone has done any work on this, but yield seems to be a very important matter, which could be made worse by having differential tax rates. Would you agree?

Elspeth Orcharton: I think that it is a crucial point. Just to clarify, I am not aware, in my discussions with HMRC, that they are doing any work on the taxpayer base. They do not have the data to take the corporation tax position any further than they have taken it at the moment because that information, which would give the yield for corporation tax for Scotland, sits within the businesses and not within any reporting that goes to HMRC, so you are automatically into a derivation of a financial model, however that may be built. On the income tax side, a further point to me is that Scotland reflects probably the rest of the UK in having a very substantial dependence on its income tax yield on something like 5% of its taxpayers. It is a very small number of individuals. I am not aware of that information and I think a separate exercise would have to be undertaken to begin to even quantify that level, which is fundamental to the debate. It would be important for all sides to try to inform this debate.

Professor Jim Gallagher: If the Committee is interested in the data of this, I suggest that you look not at the tax system but at the ONS and the Registrar General's data. They measure and project something called the dependency ratio of the population. Essentially, that is the ratio of people of working age to people not of working age. In both Scotland and the rest of the UK, that dependency ratio goes up markedly over the next 20 or 30 years. Interestingly, it does not go up by much more in Scotland, but the composition is different. The Scots seem to get older and the English seem to have more kids.

Lord Tugendhat: I am sorry, but could you say that again?

Professor Jim Gallagher: The dependency ratio is the proportion of the population, roughly speaking, under 16 plus those over 64, divided by the number in between. That number gets bigger for the whole of the UK. It gets bigger for Scotland and for the rest of the UK, but the composition differs. The Scots seem to get older while the English seem to produce more kids.

Lord Tugendhat: That is the best position to be in, is it not?

Professor Jim Gallagher: Quite so.

Q631 The Chairman: It was this demographic point that the Chief Secretary to the Treasury drew our attention to and put quite a heavy weight on last week.

Professor Jim Gallagher: Yes, he did, although I noticed that he talked only about age and did not talk about the under-16s.

The Chairman: That is correct; he only talked about age.

Jeremy Purvis: But also, Lord Chairman, when it comes to not only the demographic but also the taxpaying component of that demographic, what lies at the heart of Lord Forsyth's point is what the earning and taxpaying age is, and whether that profile is different. In our second report, *Improving Social Outcomes in Scotland*, we analysed what the contribution of the tax profile was using the HMRC data. It is clear that the contribution made by low earners in Scotland for income tax is a higher share of the overall tax take for Scotland than for the rest of the UK. The tax profile in Scotland is also different from that in the rest of the United Kingdom at the top end, where HMRC does not even have the top three layers of UK categorisation of total income when it publishes its data for Scotland. For the UK as a whole, there is a £1 million range of income down to £500,000, £300,000 and £200,000. In Scotland there is just £200,000 and above. They do not even have the published data for £300,000 earners, £500,000 earners and those earning over £1 million. The tax profile is very different. There are two conclusions to draw from that, as to whether that is an inhibitor for tax devolution, or whether, if you wanted to have tax fiscal choices made within Scotland that are more appropriately linked to both the demographic and the different policy choices in response to it, that could lead to the conclusion that we draw: there is merit in having further tax devolution, so that you put in the hands of MSPs a greater choice of fiscal levers for them to be able to adjust and incentivise. If they choose to redistribute or incentivise, they therefore have a broader set of tax choices. That is within the UK. That is the conclusion that we drew from that.

Lord Forsyth of Drumlean: You could also draw the conclusion that the Scottish tax base is very vulnerable to people getting on their bikes and moving south.

Jeremy Purvis: Most particularly at the high end, yes. However, that should provide discipline to MSPs that does not exist. To some extent, that is the point of devolution: you devolve power with the discipline that comes with it, rather than simply having the only response being spending power. If you only had the option of adjusting that with spending power, that could create more moral hazard than if you actually had taxation powers.

The Chairman: Could we come now to a question that was much exercising Danny Alexander at our hearing last week?

Q632 Lord McFall of Alcluith: Just before that, Professor Gallagher, given that I represented Faslane and Coulport for most of my parliamentary life, do you have any views on the economic implications of independence for the defence industry, the future of the UK's Armed Forces, and their assets and liabilities?

Professor Jim Gallagher: That is a big question. An independent Scotland would have a different set of defence requirements from those of the rest of the UK. You could be very unkind and say that those would be very small—that there would be a kind of Home Guard approach. Or you could say that they might more resemble those of Ireland than, say, Denmark, to take two slightly contrasting examples. Whatever they were, they could not conceivably be an attempt to project power on a scale or at the distance that the rest of the UK currently does. The rest of the UK might well want to continue to have that capability. There is an interesting contrast there. That has implications for how you would divide up the existing Armed Forces. You cannot have an eighth of an aircraft carrier; an independent Scotland probably could not even afford to run an eighth of an aircraft carrier. Although the bases cannot be moved, it is pretty clear that, if there were a share-out of the kit, it would have to be quite fundamentally asymmetrical. It is almost certain that the views of the service men and women would have to be taken into account as well. They could not simply be allocated to one country or another.

That is the first point. The second is that—although I would not claim to know that someone has done a proper profit and loss account for the Scottish economy's participation in the UK's defence business—certainly, in your former constituency, that base has a big economic impact; there is no doubt about that. There are certainly other places where that is clearly true, the most obvious of which is the shipbuilding industry.

The biggest defence question by far, however, is not the economic effect of Faslane and Coulport but the defence effect. What can we do with this kit? Is it at all possible to move it? Would it be possible to negotiate its retention? If one accepts the view of the present devolved Scottish Government, it is clear that that would be unacceptable to them. It might well be something in the process of negotiation on independence, were that to take place, where the UK would come to the table saying, "You want things from us. Well, actually, we have something that we want from you".

Q633 Lord McFall of Alcluith: The issue that obsessed Danny Alexander was that, if the Scottish Government issued its own debt, would there necessarily be a higher borrowing cost compared to that for the rest of the UK? What would the differences depend on? At the end of the day, would the UK not have to support a fiscal crisis in Scotland anyway?

Professor Jim Gallagher: To start at the beginning, if there was a sharing of the UK's national debt on independence day, there would obviously have to be some mechanism for doing that. There are two possibilities. One is that the Scottish Government would promise to send a cheque every month to the UK for its share of the interest; alternatively, the very bills themselves could be divided so that one tenth, or 8.3% or whatever it was, became Scottish instruments, or 8.3% of the instruments became Scottish. That would have to be sorted first of all but, on day one or week one, the Scottish Government would have to begin to establish a track record of paying or not paying the interest. In the end, it is that track record which will determine how the markets judge it. Until it gets such a track record, it seems unlikely that it would be able to borrow money at the same rate that the UK borrows it, which has been borrowing it without defaulting since the Napoleonic wars.

The Chairman: It seems highly likely to be a considerably higher rate, does it not?

Professor Jim Gallagher: I have no idea. If you were the markets, you would be bound to attach a risk premium to any new country until it establishes a rate. How big that risk premium is, I do not know. It might depend on whether you thought that the rest of the UK would step in in times of trouble. There is a lot of history on this in relation to federal countries—the extent to which the central Government is believed when it says that it will not stand behind a certain national entity is reflected in the spreads on the national entity debt. I have no experience of the extent to which it would happen in these circumstances but it is interesting that until recently European countries which ought not to have had a good credit rating got very good credit ratings because people thought that other countries would, in fact, stand behind them.

Q634 Lord McFall of Alcluith: What incentive would the UK have to step in in times of trouble?

Professor Jim Gallagher: The same incentive it had to give support to Ireland: good neighbourliness.

Lord McFall of Alcluith: In other words, a neighbouring country is too big to fail.

Professor Jim Gallagher: Wrong to let it fail.

Jeremy Purvis: If the Committee looks at the GERS documentation that the Scottish Government published—I admit that they have an inconsistency in part of their arguments, but it may be helpful to get an understanding of what their thinking is—they categorise the financial intervention funding as spread by population share, as they believe that all parts of the UK have been helped, rather than recognising that RBS and HBOS were Scottish banks, although they take a different view on categorising North Sea oil geographically. They have a different perspective on what a UK benefit and what a Scottish benefit is.

The only point that I would make is that, when we have been looking at the overall figures, if we take the David Hume Institute's work looking at the theoretical basis of what Scottish debt would be, under any objective view the profile would be higher both as a percentage of GDP and, certainly, as a percentage of what the Scottish budget would be, than for the UK as a whole. All the objective views have looked at that; it is not dramatic, but it is still higher. It will come down to a judgment—with the same level of debt profile, with the capacity for revenue raising within Scotland and, in the future, once the source of North Sea oil revenue declines—as to how sustainable that would be for the long term. The point that I have made previously is that this will be an irreversible decision in 2014. It is not a decision for the next 10 years, where we can go back. So it is a question of taking a very long-term view, and taking a long-term view of the viability of the sources of revenue that would underpin any sizeable country of 6 million people.

Q635 Lord Levene of Portsoken: How damaging would uncertainty be over how the tax system and other aspects within an independent Scottish economy would operate?

Elspeth Orcharton: The view of our members is that any uncertainty is bad for two groups. In terms of business, it just gives them an additional risk to consider in looking at financial projections. Even within the UK tax system and its continuous changes, however, we have called for certainty and stability, so we are not the biggest supporters of change from the uncertainty perspective. In terms of individual taxpayers it is important, if you wish to support compliance with the regime of the payment of tax, that there is certainty and clarity as to where obligations exist and how they should be met. Beyond that, it is a business uncertainty. What I would say is that a lot of our members are as concerned with another point that has not been raised today, which is the scale of changing any tax system from something in the UK to something in an independent Scotland. We do not know what that is, but the scale, process, energy and time commitment that that could absorb is almost of as much concern as the uncertainty.

Q636 The Chairman: Is that the purely administrative cost of managing a new system?

Elspeth Orcharton: There is the straightforward administration of having a different form, return, obligation or filing date, or whatever, for which there would be a compliance level. I think that another issue for a number of organisations is that they think that they would be required to contribute and consider all potential consultation documents that come out, to look at the way a new tax system is being put together and to consider whether it is a coherent piece or will have unintended consequences. Also, I suppose that our members in this context are the tax professionals or the finance professionals dealing with tax, who are obviously going to have to try to understand and explain the changeover and the new administrative aspects internally to their boards, their staff and their employee base.

Professor Jim Gallagher: Could I add something to that? It is a smallish example of a very large issue that has not been properly discussed as yet. One of the major shifts that will happen were Scotland to become independent is the disentangling of UK institutions and services that are provided in and to Scotland. Two very major ones are the tax collection system and the benefit payment system, both of which are operated on a geographically blind basis across Great Britain and, at least in terms of tax, across the UK. If you receive your correspondence about national insurance contributions, it is from an office in Newcastle, wherever in the UK it is delivered. If you pay your tax, it does not depend on where you live. Critically, the IT systems that underpin each of these are single IT systems. In both cases, you will see a great difficulty in making any change to them. The minimum expectation is that an independent Scotland would have to negotiate shared facilities for a period of time with the rest of the UK. Otherwise, in practice, they would not be able to apply taxes or pay benefits. So some continued sharing, for a while, is inevitable. I do not regard the argument that you can share these things for ever as at all sustainable.

The Chairman: It is a very interesting further example of the transitional cost.

Professor Jim Gallagher: It is a huge transitional cost.

Q637 Lord Forsyth of Drumlean: On that point, I was just thinking that if I were on the negotiating team and people had voted to break up the United Kingdom, there would be all these issues. You have the First Minister taking the position that he is not going to be responsible for the debts of the Royal Bank of Scotland, which are in the area of £47 billion. It is difficult to see how one is going to reach agreement very quickly. What then happens if they do not reach agreement very quickly? The people will have voted, and if Mr Salmond is taking an intransigent position which is ridiculous, like not being responsible for a share of the bank's debts, how would this be resolved? Would it be resolved by the courts or would we just have a period of huge uncertainty? The more I have listened to this this afternoon, the more I have thought, "This is going to be a complete nightmare". How would you resolve it? Wearing your old hat, Professor Gallagher, as a Civil Service fixer, how do you think that this would be sorted?

Professor Jim Gallagher: The defining act of the creation of independence for Scotland would be as it was for decolonisation—that is, Westminster would pass an Act of Parliament declaring that it would no longer make laws for Scotland. It would depend on a very unpleasant game of brinkmanship, I fear, if these negotiations begin with bad will. There might well be a point at which Ministers say, "We're passing that Act and you're on your own". Alternatively, there might be a point at which Scottish Ministers say, "If you don't pass that Act, we will make some kind of UDI as the political authority". These extremely difficult negotiations could only work with deep good will on both sides. I say this because I am an academic with a sense of humour who has been invited to give a paper on this subject. It is very difficult to see how it can be done without the strongest desire for co-operation on both sides.

Lord Forsyth of Drumlean: But if there were a problem, how would you resolve it?

Professor Jim Gallagher: Politically, not legally.

The Chairman: But the range could be very considerable. Of course, the respective interests of the two negotiators are very different: one is a demander, and the other is having to respond.

Professor Jim Gallagher: That is why I say that in some respects the Scottish Administration would be the demandeur on this. But they have some cards it can play—notably the defence card.

Q638 Lord Tugendhat: May I just take up your answer to Lord Forsyth? I do not know quite what you meant. In the case of Ireland, Canada or Australia, for instance, there was a Government of Ireland Act, which went through Parliament, or the Government of Canada Act back in the 1860s. That was the formula that would go through. We are assuming, because that is what the two heads of Government have agreed, that they would both be using their best efforts and so forth to make it go smoothly. None the less, the sort of problem that Lord Forsyth has mentioned could arise on some technical issue, like tax. Were it to do so, yes, political resolution would be good, but it may or may not work. To what legal authority would the aggrieved citizen appeal?

Professor Jim Gallagher: I am not sure that there is a legal authority, but if the disagreement or problem arose before Westminster had legislated in the form of the Government of Canada Act, for example, then in principle the UK courts would have jurisdiction over the actions of both sets of Ministers. If the problem continued after Westminster had given up jurisdiction, then obviously the UK courts would not.

Jeremy Purvis: Part of our consideration for our third report is to look at how we would put our Scottish Parliament on a permanent footing, where powers are vested from Westminster on currently devolved areas. We have been looking at a similar approach to the Statute of Westminster, not for the purpose of Scotland becoming independent but for the purpose of permanently vesting legislative authority. Crucially, we would consider that the Supreme Court as constituted would remain as an arbiter, although both Parliaments would be a party to it if there were a dispute between Parliaments. The point that Professor Gallagher is correctly making is that there would no longer be a UK Supreme Court if Scotland had indicated so through the referendum. While there would be political resolution for many of these issues, as has been said, what would still be outstanding is that very many private interests would depend on decisions that are made. Depending on whether or not they have made long-term investments based on assets, where they reside and whether they believe that the results of the negotiations are appropriate to and consistent with what was in the Scottish Government's White Paper—the Scottish Government have promised to publish it next autumn as their prospectus for independence—they may well seek redress in both the Scottish courts and in what would effectively be the English courts. What would still be the same is that Scots law would operate. The UK Supreme Court would not be the arbiter of that.

My final point is that you may to wish to talk to Mike Russell, who is the current Education Secretary in the Scottish Government. He held a view at one stage that it would require a second referendum for the people of Scotland to ratify the results of the negotiations. They could be dramatically different from what the prospectus of independence would be.

Lord Tugendhat: I think, with great respect, that it is rather odd to hear Scots talking in terms of a second referendum in Scotland.

Jeremy Purvis: I agree that his position was odd.

Lord Tugendhat: You vote in the coming referendum and we do not. However, if an agreement is reached between the United Kingdom Government and the Scottish Government and there is a referendum, we vote too—we would have to agree the terms, not only you, so there is a double jeopardy. We do not have a vote this time, but we would have a vote the second time.

Jeremy Purvis: I was simply indicating that that was the position that he held. I do not want to be in that situation at all; one vote is enough as far as I am concerned.

Lord Tugendhat: You might accept Alex Salmond's terms, but the people of England, Wales and Northern Ireland might not.

Jeremy Purvis: I suspect that his position would be that that would be a matter for the rest of the United Kingdom. To refer back to that position, with clarity on what the process would be, looking at how we could have a settlement within the United Kingdom, from our perspective we want to be as clear as we possibly can so that the people of Scotland are aware what the consequences of a no vote would be if there is to be further devolution. Our view is that it is incumbent on those who are proposing independence to outline to people that there is, equally, a clear consequence of what happens.

Q639 The Chairman: I think that you heard part of our last session, when our witnesses had no clear idea of what to expect before the first vote—all the consequences for their industries were going to follow later. I think that there will be a very compelling case for a second referendum, and there would be huge debate in the rest of the United Kingdom about some of the negotiations that were being undertaken by their Governments. There will be a lot of political pressure.

Professor Jim Gallagher: A perfectly rational argument was made for a two-referendum approach by a number of academics some years ago in a book about this process. Their argument was that the first referendum should be about mandating the Scottish Government to go and see what kind of deal they could do. Once they had that, some sort of deal would be put to the people for endorsement. Neither Government has followed that approach. Actually, it was never realistic, because no Government had the incentive to do such a deal. The consequence, however, is that we are inevitably going to go into this referendum with substantial uncertainties about what independence means. There are lesser but still real uncertainties about what a no vote implies. The uncertainties about independence are structural and existential. You cannot know what an independent Scotland would do; you can speculate. Nor can you know what kind of negotiation will take place. The best you can do, as a voter, is to make the best educated guess you can as to how it is going to turn out, assessing what information you find, and make a judgment accordingly. You will forgive me if I put in a commercial for the forthcoming book on this subject that I have just concluded.

The Chairman: I follow that. The purpose of our inquiry is to try to illuminate voters' minds as to all the issues and possible consequences of a yes or no vote. It is certainly very clear from the hearings that we have had that so many of they key issues—you have mentioned defence, for a start—will have to be negotiated after the vote has taken place. That looks almost certain. The political pressures on some of the potential decisions taken in these negotiations, and the pressure to challenge some of them, will be immense.

Professor Jim Gallagher: Indeed they will. There are few precedents that can help us. The only two I can I think of are the aforementioned Czech Republic and Slovakia, but in that case both sides wanted separation for their own reasons. The only UK example that we are aware of, which is not so happy, is Ireland in 1922 where the negotiations produced civil war afterwards. There are not a great deal of precedents. In the event of a vote—let us be clear that we are talking about the event of a vote—much will lie in the process afterwards.

The Chairman: Time is running out. I am looking to my colleagues to see whether there are any other issues that they want to raise.

Q640 Lord Forsyth of Drumlean: One tiny point on this: while all this uncertainty and argument is going on, have you reflected on what the likely reaction might be south of the border? I am conscious that you mention the Czech and Slovak example. We had some evidence that in the Slovak example they actually pressed for devo-max and in the end the Czechs thought, "You want to have your cake and eat it". There was pressure from the Czechs to kick them out of the union. I just wondered whether, if there is a lot of uncertainty and unreasonable negotiation, there might be the proverbial English—or, in this case, England and the rest of the UK—backlash?

Professor Jim Gallagher: I have two thoughts on that. First, what the Slovaks pressed for was not devo-max, because they already had a federal country. Undoubtedly, however, the dynamic of that was that the Slovaks were kind of dumb enough to ask and the Czechs were ready to say yes—in the end, to be fair, it has worked out well for the Slovaks; let us be even-handed about that. What we see in England is some increase in the salience of this issue: people have noticed. Since 2007, Scottish opinion on independence has not shifted, but English opinion has. That is quite significant. If you want a story, look not to Czechoslovakia but to Quebec, where one of the factors which clearly influenced the second referendum on secession was the very strong message from the rest of Canada that it would like Quebec to stay.

Elspeth Orcharton: I have a very quick comment in response to the point about all the uncertainty, and the political process and debate about that. This has been felt very strongly in ICAS in relation to our public interest role. We have an interest in trying to inform, taking the debate forward and seeking resolution. We will be continuing our series of papers looking at and asking questions, trying to elicit better clarity or certainty on positions. Fair enough, it is not laymen who really feel that this debate needs to be taken forward on so many fronts. We are perfectly willing to contribute to that by asking questions. We are conducting some independent research as well, on decisions made about tax in the Czech/Slovak countries and some of the others, to see what lessons have been learnt and what evidence can be gained from there. I would be very happy to share that in due course.

The Chairman: We have had witnesses on the Czech position and I am bound to say that I drew from it that there were not many parallels with the issues that we face now. Thank you all very much indeed for coming. It has been a very helpful end to a very constructive day. We are very grateful to you.