



# 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. 20*

*Heard in Public*

*Questions 901 - 925*

TUESDAY 18 DECEMBER 2012

3.40 pm

Witnesses: Rt Hon Michael Moore MP and Mr Alun Evans

Sir John Gieve

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Members present

Lord MacGregor of Pulham Market (Chairman)  
Lord Forsyth of Drumlean  
Baroness Kingsmill  
Lord Lawson of Blaby  
Lord Lipsey  
Lord McFall of Alcluith  
Lord Shipley  
Lord Skidelsky  
Lord Smith of Clifton  
Lord Tugendhat

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**Examination of Witnesses**

**Rt Hon Michael Moore MP**, Secretary of State for Scotland, and **Mr Alun Evans**, Director, Scotland Office.

**Q901 The Chairman:** Welcome, Secretary of State and Mr Evans. We are very grateful to you for coming. This is the 20th and final public hearing of our inquiry into the economic implications for the United Kingdom of Scottish independence. I should just mention that I believe that we are being televised. I have said several times—but at this particular meeting I think it is important—that this Committee is dealing with the economic implications, as is right for our Committee, of possible Scottish independence and not with constitutional or political issues, in so far as they do not affect economic issues. It is purely on the economic issues. We felt in the run-up to the referendum that it was critical that voters understand the economic implications and issues, and that is what this Committee is about. Do you wish to make an opening statement or shall we go straight to questions?

**Michael Moore MP:** If I may, that would be very generous of you and allow me the opportunity, first, to thank the Committee for the thoroughness and the comprehensive nature in which you have been examining the themes and issues that arise out of this, at a

relatively early stage in this whole great debate. I look forward to the conclusions of the inquiry and the report that you compose at the end of it, and will look very carefully at the issues that come out of that and the recommendations that you make. In the context of all the other witnesses you have had, I am delighted to have an opportunity this afternoon, as you conclude your hearings, to share some of my own perspectives on this.

We as politicians are often accused of hyperbole and exaggeration, but if I were to claim that this is perhaps the biggest decision facing Scotland in 300 years you might be sympathetic to that idea. Certainly, it is one that we as the UK Government take incredibly seriously. That is why over the past 18 months, since the Scottish National Party secured its majority in the Scottish Parliament and got the mandate for a referendum, we have been very keen as a Government to appropriately and legitimately be part of the process. As you will be aware, a couple of months ago, the Prime Minister, myself and the First Minister and the Deputy First Minister of the Scottish Government signed the Edinburgh agreement, which aims to secure a legal and fair referendum and one that will provide us with a decisive outcome. That is one issue that is inherent in the economic aspects of this great debate. That process, which will transfer on a temporary basis the powers to hold a referendum to the Scottish Parliament, has been scrutinised and approved by the Scottish Parliament. It is still subject to the scrutiny of this House and the House of Commons. I hope that early in the new year there will be an opportunity for that scrutiny to take place. I make no presumptions about the outcome but hope obviously to secure support for that. As we deal with that important part of the process, we are also as a Government very much engaged in the substantive issues that are now at stake. I know that you had a session with Danny Alexander, the Chief Secretary, where he went into a lot of the technical detail around this. Obviously we will be covering some of those issues today. Danny has undertaken to get back to you on a number of issues. I hope that is happening. We will certainly make sure that it does and if there are

any questions you put to me today that are beyond our technical know-how in the Scotland Office we will be happy to make sure you get the answers as well.

On the big, overarching issue about Scotland being an independent country and its economic position as an independent country, in the old days there was an argument saying that Scotland was too wee, too poor, too far away, and could not be independent. I personally do not accept that. I think we can be independent. We could be an independent country. The question for me—and I think this is true for people the length and breadth of Scotland—is: would that be better for us? Would we be more secure? Would we have greater economic opportunities? It is my firm view and the view of the Government that the answer to that is no and we are much better within the United Kingdom Government. We will not simply assert that, however, and as I announced in the other place a few months ago, we are undertaking a programme of work—the Chief Secretary referred to this in his evidence, the Scotland analysis programme—and from the beginning of this coming year we will produce what I hope will be a very useful series of papers that will set out some more of the detailed issues that are at stake, some of the basic facts and figures and analyses, to allow this debate to be as informed as possible. It is absolutely vital that whatever influences people's votes, we will be doing this on the most informed basis possible.

On the merits of Scotland as an independent country, it is my strong view, frankly, that it is for the Scottish Government and the SNP to set out what they believe are the arguments for independence. Clearly, last week you had an opportunity to cross-examine the Finance Secretary on a number of issues where I know there were differences of opinion. We are fully engaged in that debate and as one of Scotland's two Governments we are absolutely clear that we have to play a very strong role in that, but we are continuing to govern for the United Kingdom as a whole. We have made big, important announcements about decisions affecting Scotland—whether it is the UK Green Investment Bank or the future of all our

submarine fleets—that reflect that. But what we will not do is get into pre-negotiations. The Scottish Government can set out their process but we are not about to unpick the fabric of the United Kingdom when no decision has been taken to justify that. We have a responsibility to all of the UK and we take that very seriously indeed.

We are confident that we will prevail. However, we want to be clear about what would happen if there were a vote for independence. It is my view and the Government's view that that is the point at which negotiations would be triggered with what would then be the rest of the United Kingdom, as well as—again, your sessions last week in particular touched on this—the relationship with key international organisations such as the European Union, an issue that is fairly lively in the debate. We will engage in the debate but we will not pre-negotiate.

Finally, we hear from time to time members of the Scottish Government highlighting that paragraph 30 of the Edinburgh agreement is the answer to all the problems that might face them; it is the get out of jail card, some kind of magic lantern where the genie appears and they have three wishes to get rid of all the complex consequences of independence. I am confident that Members of the Committee have had the opportunity to read that paragraph. Essentially, I felt it was important that it was in the agreement because it commits us to work together in the spirit of the existing concordats and memoranda of understanding between the UK Government and the devolved Administration—that is the spirit in which we reached the agreement itself—and that we will respect the outcome of the vote. That is a really important statement up front. Afterwards we will act in the interests of the people of Scotland and of the rest of the United Kingdom. Yes, we will engage constructively and with a view to resolving difficulties between Scotland and the rest of the UK, but what we would not be doing is simply accepting that only Scotland's interests would apply in those circumstances; nor could we wish away the challenges there would be in Europe and

elsewhere where other players, nothing to do with the rest of the UK, would also have a big stake in, for instance, the terms of European Union membership.

I apologise if that was slightly longer than you envisaged, Lord MacGregor, but I hope it is helpful in setting the scene of where we are currently in this process, and I look forward to your questions.

**Q902 The Chairman:** Thank you very much. We will be exploring these issues. I ought perhaps to have said at the beginning that normally we invite the appropriate Minister—that is, yourself—to come to our final session. We actually have one final session immediately after you have given evidence, with Sir John Gieve on banking and currency issues, because it was not possible to fit that in earlier. That means that we will probably have rather a longer session this afternoon.

Coming straight to one of the key issues, clearly the position of an independent Scotland in relation to the EU is critical. A lot of our witnesses have told us that, particularly those from the business community. Therefore, I would like to start with what has become a key issue in recent weeks, as you indicated, not least in the Scottish Parliament and the Scottish media. As you will know, in his letter to us, Mr Barroso said: “If part of the territory of a member state would cease to be part of that state because it were to become a new independent state, the treaties would no longer apply to that territory”. Mr Swinney’s point on this was that he disagrees because there is no foundation in the treaty for that position to be supported. What is your understanding of that issue, and what contacts have you had with the European Commission in this context?

**Michael Moore MP:** Our view is that President Barroso’s observations were not surprising to us. They are entirely consistent with the Government’s view that the most likely scenario is that the rest of the United Kingdom would continue as the member state and that Scotland would have to apply and negotiate the terms of membership. We welcome the

contribution made by President Barroso, which is entirely in keeping with the overwhelming weight of academic and international opinion and international precedent. As for contact with the Commission, we have not gone directly to the Commission. We have not seen the need to do that. We have looked at the broad range of evidence that is in the public domain already. But it was helpful that in response to your inquiries as a Committee we have that further confirmation.

**The Chairman:** So you absolutely disagree with the point that Mr Swinney was making?

**Michael Moore MP:** I think he is fundamentally wrong. I think we have seen over the past nine months a shift from a position where the First Minister could say, in effect, that it was not a problem; Scotland's membership would be automatic and the terms and conditions would fly on as before. We have seen in the aftermath of the Edinburgh agreement and in the weeks since, first, a recognition that they had not actually been taking very serious soundings on that in terms of advice. Further to that, they have now had to concede—as indeed John Swinney did last week with you—that the terms of membership would have to be negotiated. That is the fundamental issue. One can argue whether or not the membership is automatic and transfers. That is important and it will be a time-consuming process even with the best will in the world and a strong wind, but the terms of that membership will be fundamental in terms of the opt-outs that the UK has and in the interests of Scotland's economy. I am glad we have got that acknowledgement from the Scottish Government now. Perhaps we will see that flow through into some of their other arguments as well.

**The Chairman:** To be absolutely clear, if the referendum result was a yes, the Scottish Government would have to start to start negotiating as a new member state.

**Michael Moore MP:** Correct. It is our view that that is the most likely scenario based on all the evidence and precedents elsewhere.

**Q903 The Chairman:** Following on from that, you referred to the papers that you are producing before the referendum. Mr Swinney said—in the context of negotiations with the EU—“We have always made it clear that there would have to be a process of negotiation and transition that followed that decision in principle by people in Scotland that they wished to proceed to independence. In that window between a decision on the referendum in the autumn of 2014 and the establishment of an independent country ... there is the opportunity to essentially resolve that particular question”—which is the question of what the terms of entry would be. Given that this is so crucial, and there are various other aspects, which we will be coming on to, that are so important, and we think it is important that in the referendum everyone should be aware of what these terms and negotiations are, if the first referendum was for yes, do you think it would be necessary to have a second referendum once the terms are actually clear?

**Michael Moore MP:** There are a number of different debates to be had around this issue. I have been party to some of them myself. As we considered this carefully within Government—and I have to say that on this issue, there was a meeting of minds with the Scottish Government—our determination was to ensure that we have a decisive referendum. The principle of separation will be established, one way or the other, by the referendum in 2014. That means that people will do it with the uncertainty of knowing what the terms of that separation will look like, although we wish to ensure that we resolve as many areas of uncertainty to do with what an independent state looks like and what issues would have to be resolved, so that people understand what is at stake. The two Governments, on the back of a yes vote—however unlikely that is—would then have to negotiate. We do not have a mandate as a Government. I am a Scot representing a Scottish constituency in the United Kingdom Parliament. We do not have a mandate to go off and start negotiating those terms and conditions. I do not believe that should be done.

**The Chairman:** But if there was a yes vote and then some of the terms of the negotiation into the EU are very onerous for the people and economy of Scotland, and some of the other issues in relation to the Bank of England and so on, which we will be coming on to, that means that there is a sort of blind vote in the first referendum and then people would have to wake up to some of the consequences once they negotiated.

**Michael Moore MP:** There is a huge amount at stake here. I am not going to play that down. But I do not see how you can have a process beyond that if you do not accept that the decision in 2014 is decisive. If you want it to be other than decisive, that is a different type of process that you would undertake. To my mind, it will absolutely concentrate the debate on what is at stake, and what the uncertainties are. I am not going to play down those uncertainties. Indeed, it is the Scottish Government's unwillingness to acknowledge uncertainty that has hampered the debate in the past 18 months. My view is that the fog on that particular issue is lifting. They are more willing to accept, I hope, that there is uncertainty and that, therefore, there is a lot at stake. I think people in Scotland need to understand that.

**Q904 Lord Forsyth of Drumlean:** You said that you wanted the debate to be as informed as possible. One of the things that Mr Swinney said to us last week was that they had a difficulty in establishing what the position would be vis-à-vis having to apply for membership of Europe or whether they would be allowed to remain in Europe because the Commission would only talk to Governments, and that the British Government were not prepared to engage on this issue. I find it a bit puzzling how you can reconcile saying, "We are not prepared to talk to the Commission as a Government about what the consequences would be", with saying at the same time, "We want to have a fully informed debate". Does Mr Swinney not have a point there?

As another example, we asked Defence Ministers to come and give evidence to us on the consequences of the nationalists' policy of wanting Scotland to be a nuclear-free zone, with the loss of jobs that would occur at Faslane and Coulport and the possible consequences for the British independent deterrent. The view from the MoD was, "We are not thinking about what plan B should be or what the consequences should be because we do not think it is going to happen". I live in Scotland. You live in Scotland. I want to know what the consequences of a vote in this referendum will be for the defence of the United Kingdom and also for our membership of the European Union. The British Government appear to be taking the position of not accepting that this has happened until it has happened, which must by definition mean that we do not have an informed debate.

**Michael Moore MP:** I respect the line of argument while not agreeing with it. Perhaps we can agree on this much: there will be elements of this that are, to put it mildly, inelegant in terms of how well informed people can be at the time of that vote. Short of doing those pre-negotiations, which as the UK Government I do not think it is our place to do, I believe we cannot resolve some of those issues. Dealing with the European Commission position, the Scottish Government have said they will wish to talk to President Barroso because they think he is wrong in his interpretation of the treaties and the reality of future membership. President Barroso has made it clear that he is setting out his view of the interpretation of those treaties as he sees it. It absolutely conforms with the UK Government's view on that and we will, in greater detail, set out more of these arguments in the course of the next year.

**Lord Forsyth of Drumlean:** So you will talk to the Commission as the UK Government?

**Michael Moore MP:** This is not the final word on the subject from the UK Government; we are just setting out what we are confident is the position and we will set out our more detailed arguments in support of that over the course of the next year. We do not believe it

is necessary to talk to the European Commission on this, nor would it be appropriate for us to do it with a view to having some kind of shadow negotiations when all the other many complex aspects of this process would not be known. It is not for us as the United Kingdom Government to argue over the opt-out on the single currency, on Schengen, on all the various different matters that matter so much to the Scottish economy. I accept that that creates an uncertainty but it is not an uncertainty of our making; it is an uncertainty of the Scottish Government and the SNP's making.

**Q905 Baroness Kingsmill:** In your opening remarks, you said that one of the considerations was whether or not Scotland would be better off in the event of independence and that in your view it would not. The focus of this inquiry is what are the economic consequences for the United Kingdom of Scottish independence, not what are the consequences for Scotland. It is slightly irresponsible of the Government not to focus in advance of a referendum on what those economic consequences might be. I am astonished by your remarks that there will be no negotiations, discussions or exploration of these economic consequences for the United Kingdom. If I have perhaps misinterpreted your remarks, I would be grateful if you wanted to expand a little further on them.

**Michael Moore MP:** We take the situation of the United Kingdom economy phenomenally seriously. It is, rightly, the major preoccupation of the Government as we go about our daily business. As Scottish Secretary, alongside my constituency responsibilities, along with all my Cabinet colleagues, I am very focused on that. I want to maintain the United Kingdom because I think it has great benefits to my constituents and to people across the whole of the country. I regret the uncertainty but the reality is that we are not in a position where we can create a hypothetical set of circumstances to understand what the negotiations would be. We do not have a position within Government that separates out Scottish interests from the interests of the rest of the United Kingdom. We are all collectively responsible for the

governance of the whole of the United Kingdom. As I said in my opening remarks, I do not believe it is right or appropriate for us to unpick the fabric of the United Kingdom on a hypothetical, notional business ahead of negotiations that can only properly be triggered by a vote for Scotland to become independent.

**Baroness Kingsmill:** I have to say, Secretary of State, that that seems a rather weak answer. Most corporates, when faced with a decision of this kind, would do some scenario-planning and risk management, and have some idea of what the consequences would be for the larger part of the United Kingdom. I am surprised by your answer.

**Michael Moore MP:** It may not allay your fears, but again I point to this famous paragraph 30, which in essence says that once we have the result of the referendum, whichever way it goes, both Governments will respect the fact that they will be negotiating for the interests of Scotland and the rest of the United Kingdom. That will be a point where the rest of the UK will be able to work through what it believes are the important interests that have to be resolved and the terms on which it wishes to negotiate those terms. It is not a position where people will be bounced into a particular set of outcomes without any prior thought. There is space there. We in Scotland have to respect that the rest of the United Kingdom will have its interests at stake at that time and is not simply going to offer Scotland a free pass on all of this. That is a reality of this process that we need to acknowledge.

**The Chairman:** But once that happens and the outcome, for example, is very unfavourable to Scotland or to the rest of the United Kingdom, what happens next? Presumably Scotland becomes independent on unfavourable terms, or very favourable terms, or whatever, but there is no referendum to take a final decision.

**Michael Moore MP:** But, if I may say so, and this is part of the reason we worked through this in advance of the approach we took to get a decisive referendum, you would then end up in a position where Scotland had a referendum on the principle; the detail then had to

come back to it; how the rest of the United Kingdom determined its satisfaction with those terms and conditions here in Parliament or elsewhere is yet to be resolved; and we could end up with Scotland voting yes one time and no the next time. We would get into a terrible cycle where the rest of the United Kingdom—dare I say it?—was in huge uncertainty as whether or not Scotland was coming or going. As I say, this is inelegant—if I may borrow a recent phrase, “It could be messy”—but it is the real world of politics and different sets of interests will have to be resolved. We are committed to doing that constructively. We believe that is the right way to do it and we will respect the outcome, but it cannot be an outcome that is conditional on lots of further referenda that determine whether they are the right terms or not.

**Q906 Lord Tugendhat:** You talk about the “real world of politics”, Secretary of State. In the real world of politics, Governments have a duty to undertake contingency planning. Of course I understand your point about not wishing to “unpick the fabric of the United Kingdom” on the basis of a hypothetical situation but I would not believe you if you were to tell me that no contingency planning is taking place in Whitehall about the possibility of the euro breaking up. We may well hope that the euro continues but if you were to tell me that the Treasury had not considered the possibility of the eurozone breaking up, I would not believe you. I find it very hard to believe that the Ministry of Defence has undertaken no contingency planning as to what will happen to our Armed Forces in the event of Scottish independence. At any one time, the MoD is doing contingency plans on all kinds of variables and hypothetical situations all over the world. If we are looking into what might or might not happen if the eurozone were to break up, then surely to God we are looking into what might or might not happen if the United Kingdom were to break up. If we are not, it is a dereliction of duty.

**Michael Moore MP:** Perhaps I might make a distinction, and what I hope is an important generic point about government behaviour, entirely in keeping with what you say about contingency planning and looking forward at uncertainties. There are many highly experienced former Cabinet Ministers here this afternoon and others with great experience of corporates and public life. I would make a distinction between contingency planning about unknowns, things that can be foisted upon you at an unknown time—the eurozone might be an example of that—and here, where we have a defining moment. We will know the date before too long. We know already it is going to be autumn 2014. That is the moment that will crystallise the ability to work through all the different issues.

I do not want to leave anyone on the Committee or anyone in the debate inside or outside Scotland with the notion that we as a Government are not taking seriously all the different issues. We want to ensure that they are all laid out properly. On defence, we want to highlight not only that Scotland is the home of the independent nuclear deterrent but is on track to host the UK's sole submarine base at Faslane. Equally, we want to point out that our military is so well integrated across the country that, as the Defence Secretary said at one point, it is not like a bar of chocolate where you can break a piece off and have a “Scottish Defence Force” and there are no consequences elsewhere. There are all sorts of central intelligence, logistics and other support things that are unevenly spread around the United Kingdom. All that would have to be worked through. I will not suggest for a minute that there are not consequences to that, but there are consequences that we will manage and would have to manage in the most appropriate and secure way, triggered from a point. That is why how long it then takes to resolve those issues and work them through is as much a matter of the rest of the United Kingdom's interests as it is of the Scottish Government and the Scottish people's interests. Therefore, I think that is qualitatively a different type of issue.

**Q907 Lord Lawson of Blaby:** May I suggest, Secretary of State, that your position is totally unsustainable? Leaving aside for the sake of simplicity the people of the rest of the United Kingdom, I think you are letting down very badly the people of Scotland. You said in your opening remarks that Scotland is perfectly capable of being an independent nation. I agree entirely. It is a very fine country, perfectly capable of being independent. There are many independent countries in the world that have less going for them than Scotland. But you said that the important issue is the net consequences of independence—would they be favourable or unfavourable to the people of Scotland? How are the people of Scotland to judge this if you are not prepared to say what in your considered judgment the consequences will be? That seems to be a totally unsustainable position.

You talked about the “real world of politics”. You are in the real world of politics and you are accustomed to general elections. The consequences of general elections are not nearly as momentous as will be the consequences of this referendum if it were to go for separation. Even in a general election, you would not let the other side in the debate make all the arguments about what the consequences of a particular choice would be and make no arguments yourself. You would not dream of doing that, yet this is the position you are taking up in the light of the Scottish referendum. I believe that to be completely unsustainable and I hope you will rethink.

**Michael Moore MP:** I acknowledge the strength of your contribution, but please let me make a distinction between pre-negotiating the outcome and saying, “Here is the determined outcome”, which means we have to work through and spend the next 18 months having a shadow negotiation with the Scottish Government about its proposals on the Bank of England Monetary Policy Committee and the like on the one hand, and what you do with the Armed Forces on the other—which I just do not think we have got a locus or a responsibility to do because our responsibility is to continue to govern for the whole of the

United Kingdom—and setting out the details of the issues, much like this Committee has highlighted already this afternoon and you have discussed in all your previous evidence sessions and no doubt will feature strongly in your report about the issues that are at stake.

I think you are entirely right to be pointing out all these different issues. The papers that we will publish as part of the Scotland analysis programme will set out those issues; they will highlight the strengths and the issues around the integrated United Kingdom economy and how it matters to organisations like a company in my own constituency that manufactures coat hangers: 95% of its market is south of the M62; England is very important to that company. The issue we will put to that company is: you are part of an integrated economy at the present time. If we separate, over time there will be issues that will mean that Scotland and England will diverge. I believe that is not in our best interests. We have got strength in what we have. We will highlight all those different types of arguments. What we are not doing is pre-negotiating, but what we are doing and what we fully intend to do is set out the detail of the arguments and the analyses that back that up.

**Q908 Lord Shipley:** To be really clear about the knowledge that a voter will have prior to casting that vote in a referendum, you will have laid out the issues properly and they will be shared with those voters in advance, and others will lay out issues as they see them as well. Are you confident that a voter in Scotland will have the knowledge needed to cast a vote in the referendum, which will not cause them to say, in the period afterwards when there is a negotiation, “Well, if I had known that, I would never have voted yes” or “I would never have voted no”? Are they able to make a choice because they have the information that enables them to make that choice and then not regret it?

**Michael Moore MP:** I am not sure I am qualified to speak for this hypothetical voter. Of course people can take a view subsequent to elections about whether or not they voted the right way. That is the essence of elections and politics; we all live or die by that. In terms of

our best intentions, we want to have a fully informed and robust debate. That means setting out all the different angles about the economy, which is one of the fundamental areas. We want the analyses and arguments that we present to be open to scrutiny—by your Lordships but also by independent academics and think-tanks, and the people in Scotland—and we will scrutinise what is put forward by the other side of the argument as well. It is our duty to make it as well informed a debate as possible. We will distinguish between what are from my perspective the very strong reasons for maintaining the UK, the benefits we get from being part of the United Kingdom; the areas where there will be uncertainty, where we cannot know the outcome until the post-referendum negotiations; and areas that are always open to review five, 10 or 20 years down the line.

**Q909 Lord Lawson of Blaby:** You also mentioned in your opening statement the Edinburgh agreement, to which you were a signatory, particularly paragraph 30. Paragraph 30 in its general shape is very sensible. It suggests that if there were to be a divorce, it would be an amicable divorce; to continue the metaphor, the countries would remain on speaking terms with each other and would be friendly and co-operative towards each other. However, when he appeared before us last week, Mr Swinney went much further than that. He said specifically, so far as we could understand it, that under the terms of paragraph 30 of the Edinburgh agreement, which obviously you know all about, if sterling were to be the currency of choice for an independent Scotland, the Bank of England would continue to be the central bank for Scotland. Is that your interpretation? That seems bizarre. I have had some dealings with the Bank of England in the past. But that is what he said. Is he right?

**The Chairman:** I am sorry, I am going to have to leave you time to think about that question. We have got a Division. We will be back as quickly as we can.

*Sitting suspended for a Division.*

**Q910 The Chairman:** I think we can resume. Lord Forsyth?

**Lord Lawson of Blaby:** I am waiting for an answer.

**The Chairman:** I beg your pardon. I gave you plenty of time to think about the answer and then forgot about it.

**Lord Lawson of Blaby:** I have waited a long time for it.

**Michael Moore MP:** I hope it is worth it. The answer to your question is simple. Paragraph 30 does not cover that. It does not make commitments that the United Kingdom will simply unilaterally accept every last assertion or expectation of the Scottish Government. It is particularly hard, even if you were minded to do such thing, in a situation where they have not spelt out exactly how they think that would work. No, paragraph 30 does not give them a free pass to all their policy wishes.

**Lord Lawson of Blaby:** But I asked a very specific question, not whether paragraph 30 gives them the answer to all their policy wishes. Their original idea of the euro does not look so good now so they have said that they would use sterling as a currency. Mr Swinney said the clear implication of paragraph 30 of the Edinburgh agreement was that in that event the Bank of England would be the central bank of an independent Scotland. Is that right—yes or no?

**Michael Moore MP:** No. If they chose to seek to negotiate such a situation in the aftermath of independence, that would be a different matter, but the idea that somewhere under here there is a magic paragraph that only the SNP can see that says all these things will be sorted, that is completely wrong.

**Q911 Lord Forsyth of Drumlean:** Following on from this issue of the role of the Bank of England, the Scottish Government have been telling everyone who cares to listen—I think Ms Lamont put it rather neatly when she said that everything will change but everything will remain the same—that as far as the Bank of England is concerned, it will remain as the lender of last resort, which is clearly of key importance for financial institutions. We have

asked the Bank of England if it would care to give us evidence. Understandably, the Bank wants to keep out of political debate. Last week, Mr Swinney told us that the Scottish Government had had discussions with the Bank of England, which was subsequently denied by the Bank of England, which said that it had responded to specific questions. So we are really relying on the Government to spell out what the position would be with the Bank of England. You have just answered Lord Lawson by saying, "Well, that is something that will be negotiated after the event". What conceivable reason would taxpayers in what would be the rest of the United Kingdom after Scotland had become independent want to be lenders of last resort to a foreign country; that is, Scotland? If you cannot think of a reason, why are the Government not making it clear to people that there will not be a lender of last resort and the consequences that that will have for financial institutions and for stability, given the dependency on oil revenues of the Scottish economy?

**Michael Moore MP:** I agree with you that the rest of the United Kingdom would have serious doubts over wanting to provide the lender of last resort facility. We are not the ones making the case for that being the situation after independence. What we do not have is a proposition from the Scottish Government. We have the Bank of England with responsibility for the whole of the United Kingdom, as things stand. We are invited to speculate that there would be some form of territorial representation on the MPC, which is quite out of keeping with its primary purpose and the way it is convened at present. Whether or not that was feasible, whether or not the rest of the UK regarded that as appropriate, whether or not that could be negotiated, you would have to ask yourself whether that was sufficient for the Scottish economy in the generous spirit in which the rest of the UK had allowed it to happen. I am clearly not persuaded that that would work or is desirable. The Scottish Government should set out its detail. In our Scotland analysis programme we will set out what we believe are the arguments around that and why we

think this is an easy way for the Scottish Government to try to pretend that all the difficult issues after independence will have been resolved. One might be entitled to ask, if you are keeping the currency, if you are hoping to keep the Bank of England and UK financial regulation, what kind of independence is this? But that is obviously for another day.

**Lord Forsyth of Drumlean:** Your answer is not clear to me. If we were on one of these panels or debates, which have been set up in Scotland, on the merits and consequences of independence and those who wished to break up the United Kingdom are saying, “It will be fine. The Bank of England will still be there as the lender of last resort. We will have a place on the Monetary Policy Committee”, do we have the authority and the backing of the Government to say, “No, that is not going to be the case. There will not be a lender of last resort”? What you are saying is that there might be a negotiation afterwards and you will have to wait and see.

**Michael Moore MP:** No. Perhaps I was being too generous to the Scottish Government. Our starting point is that the rest of the United Kingdom would keep the Bank of England and that would be for the rest of the United Kingdom’s economy. The Scottish Government need to stop pretending that that is somehow in the bag, that we have agreed. We have certainly not agreed to that. It would take an enormous amount of persuasion for the rest of the United Kingdom to come to that conclusion. In the papers and analyses that we will put out over the next few months, we will be setting out the basis of those arguments very clearly so that you, me or anyone else on panels up and down the length of Scotland, or talking to folk in the high streets around the country, we can answer these questions very clearly.

**Lord Forsyth of Drumlean:** So your paper will say, absolutely, there is no question of the Bank of England being the lender of last resort or of the Scots having any representation on the Bank of England, and there will have to be some kind of stability pact to control the

spending and borrowing of the Scottish Government if you are going to use the currency—is that what it will say?

**Michael Moore MP:** If I may not pre-empt the careful work that my colleagues in the Treasury are working through at the moment, our starting point will of course be that the Bank of England is for the rest of the United Kingdom. It is governed by legislation of this Parliament, not of the Scottish Parliament.

**Lord Forsyth of Drumlean:** When will they have finished their careful work?

**Michael Moore MP:** The work will be set out in the early part of next year, I hope, in very good time for all this debate to be worked through and for your Lordships to be able to re-examine the issue as appropriate.

**Alun Evans:** I was just going to add that the paper on currency and monetary policy is likely to be one of the earlier ones coming out, so it should be out in the first half, easily, of next year.

**Lord Forsyth of Drumlean:** He said the early part of next year; you are saying the first half.

**Michael Moore MP:** If you will allow us a little latitude, Lord Forsyth. Alun is perhaps being slightly more cautious, in a Civil Service way. But we want to do this as soon as possible. You are right to focus on this as a key issue of interest, not just to Scotland but the rest of the United Kingdom. We are urgently on that task.

**Q912 Baroness Kingsmill:** Secretary of State, you have modified your position somewhat since my opening question, where you gave us all the impression that you were going to go into this referendum unsighted. But you are suggesting that this Scotland analysis programme you are discussing is in fact going to make it clear to everyone what the position of the rest of the UK's Government is in relation to the economic issues in particular that the UK would be facing in the event of Scottish independence. Then you went on to say that

there would be subsequent negotiations on various issues but you would have set out in advance what your position was and then you would enter into the negotiations. In the event of a yes vote, how long do you think these negotiations would continue?

**Michael Moore MP:** I apologise to you and the rest of the Committee if you regard that as a shift. I am very happy to draw the distinction with regard to the important work we are going to do through the Scotland analysis programme, which will set out all the detail of these arguments—what the United Kingdom provides across the country for Scotland and the rest of the UK, and therefore what is at stake. It is a straightforward logical conclusion that after separation, Scotland loses its place in all these great institutions in the United Kingdom unless it wishes to negotiate its way back in, and the attitude of the rest of the UK to that is something that cannot be known in advance but, as Lord Forsyth highlights, you can have a fairly decent stab at it. We look forward to some robust involvement in those discussions by the Scottish Government, and not simply the assertions we have had.

To your point about how long this takes, I cannot offer an answer. How long do international negotiations take? How long will this take? We are an integrated United Kingdom that has existed for 300 years. We have many things that distinguish the nations within it but we have, through our economy, our defence arrangements and, as the Americans might put it, homeland security, and so much else, a highly integrated state—devolution notwithstanding. That will take time to work through.

**Baroness Kingsmill:** Indeed it will and, given what appears to be your level of preparedness at the moment, it seems it could take some considerable time. Some people are talking about two to five years. If it does take that length of time, and on the assumption that there is a yes vote, is it not then going to have the effect in terms of the uncertainty of the equivalent of a no vote? It is going to have a lot of adverse consequences. I can imagine that corporates, for example, would not wish to take investment decisions that would be

influenced by where they were going to put their headquarters or whatever because of this uncertainty. Do you not think that it would be extremely damaging to the economy—possibly to both economies—if there were a long period of negotiation post a referendum vote?

**Michael Moore MP:** Uncertainty is damaging for all businesses. It is damaging for all economies. As I say, it is not my choice or desire that we should have this referendum but there is a mandate secured by the Scottish National Party to do it; we must live with the consequences of that. Let me be clear: we as the UK Government are not just talking about what is at stake but these analysis papers will set out what the strengths are for the whole of the UK for having Scotland as part of it and for Scotland being part of the UK. We will also, by the actions that we are taking, be demonstrating to investors and corporates—and I talk to senior business figures in Scotland or, as I did last week, in north America as well—in a way that shows a) that we are making the right arguments; b) that we are putting our own money where our mouth is, in terms of our confidence about Scotland's continued place in the United Kingdom; and c) that Scotland remains a very good place to invest, and I want that to remain the case throughout this process.

**Q913 Lord Skidelsky:** Witnesses expect an independent Scotland to obtain a geographic share of North Sea tax revenues but to lose transfer payments from the Barnett formula. They argue that, as things stand, they will broadly cancel each other out. What is the Government's view on that? Given the fact that, as some experts believe, Barnett transfers are more predictable than oil revenues, what do you think would be the effect on the UK economy of a weakening of the Scottish economy as a result of the sources of its revenue drying up?

**Michael Moore MP:** The issue of the United Kingdom's natural resources and Scotland's share of those is, again, a big area for debate and argument. Again, we can establish—the

Scottish Government do this every year with some of their reports—per capita allocations or geographic allocations of oil and gas revenues. Again, that would be an issue for negotiation after the event, but even on the most positive outcome from a Scottish perspective, one can see that those revenues are volatile, and we have a finite set of natural resources. I pay tribute to the oil and gas sector for its amazing ingenuity over many decades, which has extended the lives of North Sea oil and gas, and developed fields west of Shetland and elsewhere. We can continue to develop that and be as creative as possible but I think everyone has to accept that there is volatility in the price; there is sometimes volatility in the production, and I think you make an important central point that with the funding allocations within the existing UK state, there is a degree of predictability, which is in the interests of Scotland and the rest of the United Kingdom. One can work that through. It has been one of the underpinnings of devolution—quite different from independence—that the Scottish Parliament and by extension the Scottish Government have been able to look ahead with some confidence at the revenues they will have.

**Lord Skidelsky:** Yes. It is clear that there will be negotiation about revenue-sharing from oil but the Government will make it clear that the Barnett subsidy will stop?

**Michael Moore MP:** Without question, an independent Scotland will have to raise its own taxes in Scotland—end of story.

**Lord Skidelsky:** No wriggle room there?

**Michael Moore MP:** Your question helps to crystallise the difference between independence and devolution. Independence is about a separate state, raising its own revenues, determining all its expenditures and having to live with the consequences, whether that is a good or bad thing. If somebody suggested that there would be ongoing United Kingdom Treasury-sourced funding for an independent Scotland, one would ask whether that was really independence and I am sure that people in the rest of the United Kingdom

might have something to say about that. In fairness, I have not heard even some of the more optimistic members of the Scottish National Party make that case.

**The Chairman:** Some of the same arguments might apply to the question of the Bank of England acting as lender of last resort.

**Michael Moore MP:** For the reasons that I have already set out in response to Lord Forsyth, I think it is highly unlikely that that would be acceptable position for the rest of the United Kingdom. It is the habit of the Scottish Government and the Scottish National Party simply to assert that that will happen. The whole of the rest of the United Kingdom would have to be extraordinarily generous both in spirit and intent to take that on. I am not suggesting that is beyond the rest of the United Kingdom but one would have to ask why that would be sensible or why it would be done.

**Alun Evans:** The other point, may I say, in response to Lord Skidelsky's point about oil and gas revenues is that at the moment oil and gas revenues are only about 1% to 2% of UK revenue. If Scotland were independent, they would be 16% to 20% of Scottish revenue. Much greater volatility obviously causes more difficulty in absorbing that.

**Q914 Lord Shipley:** Secretary of State, will one of your issues papers be on the subject of defence? Do you have any estimate of the economic value of UK defence assets in Scotland? Very specifically, we have heard from other witnesses that an independent Scotland's defence sector could shrink rapidly following independence, largely because the rest of the UK would place defence orders at home rather than in Scotland.

**Michael Moore MP:** The defence sector is hugely important in Scotland, both in terms of the presence of the Armed Forces and because of the defence industry itself. I will lay out some of the figures for the Committee. As an integral part of the United Kingdom, we have 15,000 MoD personnel in Scotland: 11,000 regular Armed Forces and more than 4,000 civilian personnel. There are also approximately 3,000 volunteer reserves and 17,000 cadets.

The UK defence budget is £34 billion, the fourth largest defence budget in the world; in addition, there are all the different intelligence budgets, which amount to roughly £2 billion. That scale allows us to invest for the whole of the UK's defence in some of the most sophisticated defence equipment and systems we could hope for. Many of the MoD's prime contractors are based north of the border, including BAE Systems, Raytheon, Rolls-Royce, SELEX Galileo, Thales and Babcock Marine. It is a huge industry for Scotland: more than 12,000 people and annual sales of £1.5 billion. When you look at individual projects like the Queen Elizabeth class carriers, there is £1.3 billion and 4,000 jobs directly linked to the programme. These are hugely important for Scotland and the United Kingdom, but there is also an asymmetry. We have capability in Scotland, whether it is in defence industries or the actual military footprint, which is not replicated elsewhere in the UK. It is a big area of work that will be important economically as well as in defence terms. But we will have a paper and that will set out all these details for your and other people's consideration.

**Lord Shipley:** Will it address the issue that there might be a rapid shrinking of the defence industries in Scotland?

**Michael Moore MP:** Again, in evidence to Committees in the House of Commons, Defence Ministers have set out what has been the practice. There are exemptions from competition rules that allow national Governments to place orders for big military projects in their home territories that would otherwise, if they were a different type of commercial operation, have to be open to competition. Anyone who has been to Govan or Scotstoun and seen the Type 45 destroyers or the Queen Elizabeth carriers being built, or seen the amazing project being assembled on the Forth at Rosyth, can appreciate the sheer scale of what Scotland might turn its back on. I am not suggesting that another series of aircraft carrier proposals will be coming along any time soon, but Scotland contributes a huge

amount in shipbuilding and elsewhere. The Raytheon facility in Fife recently secured a big contract from the MoD, again for a UK-wide capability.

**Q915 Lord Lipsey:** The SNP predicts that independence would be followed by a great unleashing of Scottish entrepreneurial energy and initiative. Is that a subject that one of your papers will address, and from what you have seen of the evidence so far, do you think that is a likely outcome?

**Michael Moore MP:** Scotland has a fantastic tradition of entrepreneurs, as have other parts of the United Kingdom. There are many who grace the Scottish economy at present. There are many efforts taken by the Scottish Government under its existing powers to encourage that further. There are lots of great businesses that support one another in their efforts to encourage the next generation of entrepreneurs. I personally think that that wealth creation is absolutely fundamental to us. We can be proud of our track record. We can be confident that we can continue to develop new entrepreneurs. Have we ever got as many as we should have? I do not think so. I think we need to do more of that. I wait to see the arguments that suggest that entrepreneurship will be more obviously encouraged by Scotland being independent. In the UK it is one of our main objectives at the moment to encourage more entrepreneurs, through our reforms to the tax system and what we are doing to encourage people to invest in entrepreneurs' projects or to go into business by reducing corporation tax. We can do all that on the scale of the United Kingdom and on the basis that it is not specific to where you come from. I do not believe that independence is the key to unlocking any additional entrepreneurial flair; we should do more about it at the present time.

**Lord Lipsey:** I did ask whether you are planning a paper specifically on this topic as part of the series you are producing.

**Michael Moore MP:** Apologies. Not a specific paper as such but we will clearly look at all the different aspects of the economy and I take note of the Committee's interest in this particular issue.

**Q916 The Chairman:** Secretary of State, we have had a long session. Are there any other issues that we have not raised that you would like to put to the Committee?

**Michael Moore MP:** I appreciate that it has been a compressed session. My sense is that there are lots of other areas that we might explore. I would like to simply reiterate my thanks for the opportunity to be here this afternoon and for the work that the Committee has been doing. I recognise that there are a range of issues that you want to look at further. I appreciate that until you have seen the papers from the analysis programme you will reserve judgment, but that is a serious programme of work. It will come in the public domain from the early part of next year and I look forward to your further scrutiny of those papers and other contributions you will make to the debate.

**Lord Forsyth of Drumlean:** Perhaps I can just ask a quick question that flows from the Secretary of State's opening remarks. You pointed out that both Houses of Parliament would have an opportunity to scrutinise the Section 30 order when it comes before Parliament. I think it comes before this House on 16 January. Would it not have been better for us to be able to scrutinise it once we knew the question and the date of the referendum, and the rules pertaining to the referendum? Otherwise there is not really a lot to scrutinise, is there?

**Michael Moore MP:** I am aware of the Motion that you have placed for debate alongside the Section 30 order. I do not wish to prejudge the debate and the arguments that you will make in the course of that, Lord Forsyth. Let me put it this way: we set out a very clear objective when we published the consultation last January that we wished to secure a legal, fair and decisive referendum, and that we wish to do that by devolving power to the Scottish

Parliament because fundamentally, in the spirit of devolution, to which I am personally very committed, it was important that this was a referendum made in Scotland. I believe that with the terms of the Section 30 order, which make this a single question on independence, with only one referendum on that day, before the end of 2014, we secure the legal aspects of this and make sure that we get the decisive outcome. I believe that the Edinburgh agreement, sitting alongside the Section 30 order, commits both Governments to a proper process where the Electoral Commission plays its usual and proper role in assessing the question and the rules of the referendum, and setting such things as the campaign finance limits. That is the right way forward and the right balance. It can give the country the confidence that this will be a fair referendum and it will give us the certainty that we will have a decisive outcome.

**Q917 The Chairman:** Secretary of State, you have acknowledged that this Committee has been doing a great deal of work looking at all the issues pertaining to potential Scottish independence, from the point of view of both Scotland and the rest of the United Kingdom. As a result of all the evidence, we have been coming to conclusions about huge numbers of areas where there are still great uncertainties. We are also very concerned that, despite all the papers that will come forward, there are issues for negotiation after a vote, if it is a positive vote, which are absolutely critical for the outcome for both Scotland and the rest of the United Kingdom. It would be helpful if you could give us a note listing the papers that are about to be published next year, and the timetable. We have asked the same of the Chief Secretary and he has offered to try to help us. It would be helpful if you could give us a note so that we have some understanding of when all these issues will be put forward from the UK Government's point of view. I hope we may be able to return to these issues once we have seen them. Meanwhile, thank you very much indeed for giving evidence to us this afternoon.

**Michael Moore MP:** Thank you for the opportunity. Implicitly I was saying yes, you will get a note. It is important for Parliament and for the public debate that people will know when these papers are going to be published in the appropriate way, and as soon as is appropriate we will make sure that happens.

**The Chairman:** I hope it will reach us before we actually publish our report. Thank you very much.

### **Examination of Witness**

**Sir John Gieve,** Former Deputy Governor for Financial Stability of the Bank of England.

**Q918 The Chairman:** Sir John, thank you very much for coming to our final session in public, actually, of this particular inquiry. The Bank of England and the governor declined to give evidence to us, perhaps for understandable reasons, but the subjects we would like to explore with you are absolutely critical in our report. We are very grateful to you, as a former deputy governor for financial stability of the Bank of England, giving us this final evidence. Can I begin by asking a question you have heard we have put to others, but it would be helpful to have your view on it? John Swinney would like an independent Scotland to use sterling as its currency. Could a Scottish Government use sterling without the agreement of the Government of the rest of the UK? Would it be in the rest of the UK's interests for Scotland to continue using sterling?

**Sir John Gieve:** As a preliminary, I should make clear I left the Bank three years ago, so I do not speak for them.

**The Chairman:** I understand.

**Sir John Gieve:** Indeed, I suspect that many of you know more about this than I do. These are personal opinions drawing on my experience.

On the question “Could Scotland continue to use sterling?”, it is not quite clear what he meant by that but, in principle, yes. You can have currencies that cross different territories. Notably, effectively, Ireland—the Republic—used sterling or their own currency tied to sterling for many years so, in principle, that could happen. Having the Bank of England as their monetary authority and central bank, of course, goes a lot beyond that. There is the question of bank notes, the terms on which any notes were issued, and of course Scottish bank notes are already issued. There is the question of government accounts with the Bank of England, which still I think manages—it certainly did when I was there—the top level and high-value accounts for the Government. There is the question of clearing and settlement; there are the open market operations and whether Scottish banks would participate in those; there is the discount window and lender of last resort. There is a whole gradation of things that central banks do, and I guess there would have to be a negotiation over all of that list to decide which bits applied to Scotland.

On the question of whether it is in the interests of the rest of the UK, I guess, as a member of the rest of the UK, it would be convenient not to have to change my currency going on holiday or business to Scotland. There would be some benefits in not having that inconvenience, but it depends how far down the list you are going to go.

**The Chairman:** But some of these issues are really very important. You probably heard our earlier exchanges with the Secretary of State. We know from John Swinney’s appearance before us last week that he was wrong in saying that the Scottish Government had been involved in discussions with the Bank of England. To what extent do you think these need to be sorted out before they vote on the referendum, or can they simply be left to negotiations afterwards?

**Sir John Gieve:** He also said that he was going to produce an issues paper that set out the UK Government’s views on these issues, and that might clarify their attitude to some of

these questions. A lot of this is for the UK Government and Parliament, not for the Bank of England. When Scotland becomes independent, the Bank of England remains the bank of the United Kingdom and is subject to Westminster law and the Westminster Government. The decision, if you like, on how far Scotland continued to use or have access to the central bank would be an issue for the Government—this Government—

**The Chairman:** The UK Government.

**Sir John Gieve:** —to some degree. Just going back to the basics of notes and coins, I suppose a Scottish Government could pass a law saying that English notes are legal tender in Scotland. Actually, English notes are not legal tender at present; no notes are legal tender in Scotland, but coinage is throughout the UK. If they are an independent Government, they could, I think, say that they would settle their debts in English currency. It would then be a question for the rest of the United Kingdom Government to decide whether they were content for that to happen and, if not, what measures they take to prevent it if they did not like it. There are a lot of mechanics in that. There is a note circulation scheme to try to ensure that there are enough notes in all parts of the UK at all times, which is run by the Bank of England, so there would be a question: is it going to run a note circulation scheme which covers Scotland, or is it only going to make sure the notes circulate round the rest of the United Kingdom? There are a lot of practical issues behind this.

**Q919 Lord Tugendhat:** We are really covering a whole lot of questions almost as one, Sir John. There is a distinction, as I think everybody now is fully aware when they look at the euro area, between the currency area having a common currency and the other arrangements that flow from it. I wonder therefore whether you feel that the Bank of England could provide lender of last resort services and the other services. Presumably it could, just as it is intended that the ECB should provide a number of services to a number of countries. This in effect would involve a banking union and perhaps a fiscal union as well

between the independent kingdom of Scotland and the independent kingdom of England, just as we are seeing in the eurozone.

**Sir John Gieve:** First of all, on lender of last resort, it is important—

**Lord Tugendhat:** And the other services.

**Sir John Gieve:** Yes. Just on the lender of last resort: the bit that the central bank does, traditionally, is lend on good security to banks that it considers solvent. It takes collateral against that lending. There is a stage beyond that when the bank is not solvent or is not certainly solvent and someone recapitalises it or guarantees it. That is sometimes called lender of last resort. That is not the traditional central bank role; that is the Government's traditional role. For example, we lent a lot of money to HBOS in expectation of a recapitalisation and the Government put the money into the bank. On that point, let us suppose you have a large Scottish bank—you do have one large Scottish bank still. The Bank of England might lend to it if it thought it was solvent and would repay, but it would take account in doing so of the strength of the fiscal covenant that might lie behind it. It would be judging, if you like. The Bank of England deals a lot with Deutsche Bank, which is regulated in Germany and is a German bank. Clearly, it has to be solvent under the normal tests but I dare say that the Bank of England takes some comfort from the fact that the German Government is definitely able to support it, should it wish to do so. On the other hand, you obviously had the Icelandic banks where that was not the case. In the end, we did put a lot of money into saving Icelandic depositors, but I do not think anyone would be keen to repeat that experience. The fiscal covenant that lies implicitly behind big banks is important in how far the Bank of England would be willing to deal with them in any of these stages, whether it is open market operations, settlement or extraordinary liquidity.

Sorry, that was just the first part of the answer. Is it conceivable that the UK Government could decide to, so to speak, leave things as they are—ie, with an implicit guarantee or

whatever? I would have thought that they would think very hard before doing that, precisely because of the experience in the rest of Europe.

**Lord Tugendhat:** The link between the banks and the sovereigns.

**Sir John Gieve:** Yes, I think that is right.

**Q920 Lord Smith of Clifton:** You have almost answered the question, but if the Bank of England were to provide services such as clearing and lender of last resort to an independent Scotland's institutions, would it be necessary for the Bank of England under the Prudential Regulation Authority to regulate the Scottish institutions? Or are you saying otherwise—if we were happy with things as we are with Deutsche Bank but we were not with the Icelandics? Where do we stand on that?

**Sir John Gieve:** This also goes to the question you were discussing earlier about whether Scotland would remain in the EU, because under EU law or indeed under the European Economic Area banks have rights to operate in different parts of the area. The Bank probably could not wilfully decide not to deal with a Scottish bank or a branch of a Scottish bank that met the declared criteria any more than it can decide to refuse to deal with a German bank, if it is inside the European Union. That of course does not apply to supplying ELA, which is exceptional support outside the published schemes, and the assumption which I think has been reconfirmed by the agreement just reached between America and the Bank of England. The presumptions under which they would operate in resolutions and recoveries are that the sovereign for the territory where the bank is registered would take responsibility for resolving and, if necessary, supporting the bank in question.

On this question of regulation—would it be necessary to regulate the Scottish institutions?—not really. It would not be necessary but, in deciding what facilities to offer and how far to deal with a bank as its counterparty, the Bank of England would want to take account and some reassurance of how tightly it was regulated. If it was satisfied that there

was a Scottish regulator operating to identical standards as operate in London and so on, it would probably be content with that. It might not be efficient but—

**Lord Smith of Clifton:** But you might start off by being content but, over time, if things deteriorated in some sort of way, one would constantly have to hold this under review.

**Sir John Gieve:** Yes. I thought it was unclear under Mr Swinney's testimony whether he was saying there would be a separate PRA in Scotland, or maybe we are going to have two regulators in the UK. I was not sure how many of those he was going to replicate in Scotland and how far he was going to rely on, for example, the Bank of England to do prudential regulation as well as set macroprudential policy.

**Q921 Lord Forsyth of Drumlean:** May I just ask something, being devil's advocate for a moment? I understand the position you are describing in terms of the role of the Bank of England as lender of last resort but, if we think back to 2008 and the collapse of the Royal Bank of Scotland, and if we imagined that we had an independent Scotland on our borders, would not the reality be that an independent Scotland would be too big to fail, as far as the rest of the UK economy was concerned, and that the Bank of England would have to act because of the consequences for the economy overall?

**Sir John Gieve:** If you reached the same circumstances, of course. It would be a decision for the Government more than the central bank at the point of crisis. Even the decision to provide exceptional liquidity support to Scotland was approved by the Chancellor here. Yes, of course the British authorities could face a very unpalatable choice. Arguably we came very close to that with Ireland, which is an independent country. There was a question of whether we should help them. There was quite a political debate about that—whether we should join the European support package for the Irish. We did, because the Government here said, "It is very much in our interests to prevent the Irish economy breaking up in disarray". That would be even more so with Scotland.

**Lord Forsyth of Drumlean:** One has to bear in mind that the reason that the union came into being in the first place was because Scotland had gone bust, because of a property bubble. It is hard to imagine that, in a real crisis, England would not have to intervene. Presumably the price of so doing would be very much higher, as was the case with Ireland, where we lent them the money, I think, at 6% and we were borrowing it at 0.5%.

**Sir John Gieve:** Yes. As we can see with Greece, it all depends how serious the difficulties are. The price can come down. If what you would be negotiating if Scotland became independent were the normal operating procedures and policies and what they could rely on, there is always a question of: if things go so badly off the rails, would you then think it is in your interests at your discretion to step in and help? You may do, but that will depend on the circumstances and on what is going on in the rest of the United Kingdom. It will depend if there is the capacity in the rest of the United Kingdom to intervene, or whether they too are in difficulty, and so on and so forth. There is a difference between what you have the right to, because it is written into an agreement, rules, treaties and law, and what may happen. If you look at Greece at the moment, there are some people saying, "We will in the end be supported even if we don't meet the conditions, because it is in the interests of the rest of Europe to support us". They may be right, but it is a pretty brave bet. That would be the situation.

The other point about RBS, the Scottish bank, is that most of its operations are not in Scotland. Even its operations in the United Kingdom are concentrated outside Scotland, and it has got many subsidiaries which are actually incorporated outside Scotland. So it would be a messy situation because it is a major English bank as well as being a major Scottish bank.

**Q922 Lord Lipsey:** We have mostly been discussing the wide interpretation of what Mr Swinney said to us about macroregulation. Are there not also fairly major problems if you have two different regimes for what we used to call consumer regulation? There might be

less heavy requirements on a Scottish insurance company than on an English insurance company, so English companies all move north of the border, offer cheap cut-price insurance that is not very regulated, that goes belly up and all the people in England say, “Gosh, it’s the English Government should have saved us from this. We don’t care that it was the Scots who did it. Give us our premium back.” Is that not quite a problem of regulatory arbitrage?

**Sir John Gieve:** Yes, it is, but it is not different in type to the problem that already exists within the EU. Suppose Scotland actually settled for a currency board arrangement, which would be more conventional than simply using the existing British central bank, but it tied its currency closely to ours and it had its own regulator. Yes, of course there would be constant options for tax and regulatory arbitrage which would no doubt be very irritating to both sides of the border. There would be costs incurred and, for any bank that operated on both sides of the border, there would be two sets of regulators so there would be compliance costs. Luxembourg has its own regulator, and it is separate from Belgium and Holland and has its own tax regime. We could live with them, but there would certainly be costs.

**Q923 Lord Shipley:** Reforms have been discussed in Europe, including a single financial regulator and access to emergency funding from the ECB. Are those reforms likely to strengthen the case for an independent Scotland joining the eurozone? Might it not be better to share a common central bank with other countries than to reach complicated regulatory agreements with the rest of the UK? To put it another way, in a sterling area Scotland is likely to be a junior partner; if it were to join the eurozone it would be an equal partner with the other countries.

**Sir John Gieve:** It would be a very junior partner in the eurozone. It would be a bigger partner in a sterling zone, it strikes me. Of course, if it became independent it might choose to join the euro, and the big consequences it has to think about are the economic

consequences. Is that going to be the best arrangement for getting the policy that they need to sustain the Scottish economy and allow it to flourish? The negotiations they would have to go through to join the eurozone and to join the new regulatory arrangements in Europe are likely to be just as complex as the ones to, if you like, hang on to the rest of Britain. There are some common elements, but it is just as difficult. The real worries about joining the euro are, I guess, that we then do have a currency exchange with the rest of the UK which does produce a barrier to trade and mobility, which I guess they think would be damaging, which is why they would like to stick with sterling.

**Q924 Lord Forsyth of Drumlean:** Can I just go back to this business of the position of a large bank like RBS? The present Governor of the Bank of England—I cannot remember when, but at some stage when we were doing an inquiry into another matter—made the point to us that one of the issues for Britain in terms of our financial crisis was the size of our banks and their balance sheet relative to the national balance sheet. Indeed, he has gone on to develop that argument for breaking up the banks and separating investment banking from the rest. I am just thinking about the position of RBS, which you quite rightly pointed out had got branches and operations in other jurisdictions. In an independent Scotland, which would have a considerably smaller balance sheet relative to RBS's, notwithstanding that it is operating in different countries, and also, given that an independent Scotland would be a new country with no track record, I am wondering: would that mean that the ability to operate a bank of the size of the Royal Bank of Scotland in Scotland would be a very much more expensive and difficult undertaking? Might there not be a temptation for a large institution like the RBS to move south where the costs of capital and their position relative to the size of the country might be less adverse? I hope that is not a loaded question.

**Sir John Gieve:** It is a loaded question, and I am not sure I can answer it. I am sure that that would be an issue for whatever banks. I do not know how the company law position would

be sorted out. After all, that is all to be decided too. They were registered UK companies with Companies House, so they would probably have a choice where to register, and they would certainly consider it, but I do not know which way they would go. The difficulty we faced was that we came very close to having banks which were too big to save, not just too big to fail. So did Switzerland and so did Ireland. Only Iceland went over the edge, actually, and could not save them, and it brought the whole economy to its knees. Ireland came very close. We and Switzerland were one stage away. It is no coincidence that it is Switzerland and the UK that have been keenest to up the capital requirements on their banks and the liquidity requirements on their banks inside Europe, precisely because they have come very close to that vulnerability. If you were really sitting in an independent Edinburgh taking responsibility for RBS and the rest of the Scottish banking sector, you would have to think very carefully about what capital and liquidity requirements you set, because you might have a bank that was too big to save and therefore had to be in all circumstances proof against failure.

**Lord Forsyth of Drumlean:** So how would you cope with that? Ask it to go?

**Sir John Gieve:** What the Swiss have been doing is increasing their capital requirements very substantially, which I think is itself causing UBS and Credit Suisse, which are the two international houses, to reconsider their business models. You have seen UBS deciding to pull back, and I think both banks have considered resplitting their operations in the past, to put their investment banking outside Switzerland. They have not done that yet, but they could. You would be in that sort of a world. We are already in that sort of a world in the UK; we are going for super-equivalent capital requirements. As you know, there has been a debate: will HSBC leave? Will Standard Chartered leave? Will Barclays reregister in New York? That is an issue we face as a UK; it would be just as acute—maybe more acute—for a Scotland.

**Lord Forsyth of Drumlean:** Going back to RBS and an independent Scotland: when you use a phrase like “reconsidering their business model”, what that actually meant in the case of UBS was firing tens of thousands of people and reducing the scale of their operations.

**Sir John Gieve:** Yes. That is their most recent decision—to pull out of some parts of investment banking, or at least to downsize them very substantially. In fairness, though, that is happening right across the banking sector, and RBS itself is at the moment changing its structure and its business very dramatically. If we are talking about three or four years’ time, RBS will be a different shape even to what it is today.

**Q925 Lord McFall of Alcluith:** Just to add to Lord Forsyth’s points: if you were a non-executive director of an insurance company in Scotland which had 95% of its business in the rest of the UK and 5% in Scotland, what advice and thoughts would you be bringing to the table for the chairman and the board of directors, if there were two regulators?

**Sir John Gieve:** As a non-executive director, I would think very carefully about all the options and collect all the information, and then make up my mind. I have got no idea. There is no presumption, or there has been much less of a presumption, in the insurance sector that you rely on the Government to bail you out. In fact, many insurers have gone bust without being supported, so that sort of worry—is this Government going to be able to stand behind me?—would not be so serious. On the other hand, you would no doubt make your choice on business reasons. Would it be easier to raise the money you need in London? Would you have as good a relationship with a new regulator in Scotland as you have with what will then be the Bank of England? Maybe you would have a better one; I do not know. I am not going to answer the question definitively.

**Lord McFall of Alcluith:** I understand.

**Sir John Gieve:** Clearly, any company in that position would be considering: “Where do I place my headquarters?”

**The Chairman:** Sir John, we are very grateful to you for coming and dealing with a number of the issues that we were not able to discuss with the Bank of England. Thank you very much indeed. That concludes our public hearings.